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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124

THE FIRST NATIONAL BANK OF CHICAGO,
A NATIONAL BANKING ASSOCIATION,
Plaintiff,

vs.

THE UNITED STATES.

PLAINTIFF'S BRIEF.

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THE FIRST NATIONAL BANK OF CHICAGO,
A NATIONAL BANKING ASSOCIATION.

vs.

THE UNITED STATES.

PLAINTIFF'S BRIEF.

This case is before this Court by virtue of an order entered June 2, 1930, by this Court, granting plaintiff's petition for a writ of certiorari to the Court of Claims of the United States.

I.

STATEMENT OF CASE.

In this suit The First National Bank of Chicago seeks to recover $9,124.70, representing an additional income tax assessed and collected as a result of the disallowance by the Government of a deduction of interest paid by the plaintiff's two affiliated Joint Stock Land Banks on their outstanding bonds in the year 1922. The single issue as to the deductibility of such interest turns primarily on the interpretation of the so-called exception clause of Section 234 (a) (2) of Title II of the Revenue Act of 1921 (the Income Tax Law of 1921). This exception clause, qualifying the general provision of said Section 234 (a) (2) which allows deduction of "all interest paid or accrued within the taxable year", denies deduction of interest paid or accrued on indebtedness of the type specified in the exception clause.

A.

STATEMENT OF FACTS.

The case was heard below on a stipulation of facts, which was adopted substantially verbatim by the Court of Claims as its Special Findings of Fact. (R. 12 *et seq*)

The essential facts, taken from the Court of Claims Special Findings of Fact, are as follows:

The First National Bank of Chicago, a national banking association, of Chicago, Illinois, on or about March 14, 1923, filed with the Collector of Internal Revenue at Chicago a consolidated corporation income and profits tax return for the calendar year 1922, which return consolidated the income of the plaintiff corporation and the following affiliated corporations:

> First Trust and Savings Bank, an Illinois corporation, Chicago, Illinois.
>
> First National Investment Company, now First-Chicago Corporation, an Illinois corporation, Chicago, Illinois.
>
> National Safe Deposit Company, an Illinois corporation, Chicago, Illinois.
>
> First-Trust Joint Stock Land Bank of Chicago, a joint stock land bank organized under the Federal Farm Loan Act of 1916, with its principal office in the City of Chicago, Illinois.
>
> First-Trust Joint Stock Land Bank of Dallas, a joint stock land bank organized under the Federal Farm Loan Act of 1916, with its principal office in the City of Dallas, Texas. (R. 13)

In computing its income in said consolidated return the plaintiff deducted the amount of $78,807.80 as being interest paid during the year 1922 on Joint Stock Land Bank bonds of the First-Trust Joint Stock Land Bank of Chicago and the First-Trust Joint Stock Land Bank of

Dallas, but said deduction was and still is denied by the Commissioner of Internal Revenue. (R. 13)

Subsequent to the filing of said consolidated return plaintiff made certain claims for refunds and credits in regard to items not at issue herein and the Commissioner of Internal Revenue, still denying and disallowing the deduction of interest paid by said Joint Stock Land Banks, redetermined the total tax liability of the plaintiff for the year 1922 and fixed it at $430,784.08,—refunding to the plaintiff $4,466.53 representing the overassessment and overpayment by the plaintiff based on such redetermination. (Rec. 14) This question of deductibility of interest paid on their bonds by said Joint Stock Land Banks is the only matter in dispute between the plaintiff and defendant in respect of plaintiff's income tax for the year 1922.

The First-Trust Joint Stock Land Bank of Chicago and the First-Trust Joint Stock Land Bank of Dallas, which were organized under the Federal Farm Loan Act of July 17, 1916, issued to and/or had outstanding in the hands of the public in the year 1922 their Joint Stock Land Bank bonds, respectively, on which interest was paid and/or accrued in the year 1922 in the aggregate sum of $78,807.80. (R. 15) Included in said amount of $78,807.80, however, is the amount of $5,810.25 in respect of certain inter-company transactions which the Commissioner of Internal Revenue, in his final determination of the taxable net income of the plaintiff for said year 1922, allowed as a deduction and which amount the plaintiff concedes is not deductible provided the interest paid by said Joint Stock Land Banks on their outstanding Joint Stock Land Bank bonds, as herein contended, is held to be a deductible item. (R. 14) The net deduction at issue, therefore, is $72,997.55, involving a tax refund, if allowed, of $9,124.70. (R. 15)

Said Joint Stock Land Bank bonds were issued and sold by said Joint Stock Land Banks, in accordance with the provisions of the Federal Farm Loan Act and the regulations thereunder, and were secured as to payment, as required by the Federal Farm Loan Act, by the deposit with the proper Farm Loan Registrars of farmers' promissory notes evidencing loans to farmers, which in turn were secured as to payment by said farmers', first mortgages on their farms, respectively. (R. 15)

Proceeds coming to the hands of said Joint Stock Land Banks from the issue of said Joint Stock Land Bank bonds were used by said Joint Stock Land Banks to make new additional loans to farmers, which new loans, made from the proceeds of said Joint Stock Land Bank bonds issued and/or outstanding in 1922, were made in each instance in consideration of the making and delivering by the borrowing farmers, respectively, of their promissory notes secured as to payment by first mortgages on their farms. (R. 15)

All of said loans, respectively, and farmers' notes and mortgages, respectively, evidencing said loans, were designed to be and were of such a nature as to comply with (1) all the terms, conditions, restrictions, limitations and requirements specified in the Federal Farm Loan Act, as requisite to qualify said loans, notes and mortgages as "First Mortgages" in contemplation of said Act,—so as to make them available as collateral security against the issue of additional Joint Stock Land Bank bonds, and (2) all terms, conditions, restrictions, limitations and requirements, statutory or otherwise, specified in the laws of the State in which the particular farm was located, to wit, the States of Illinois, Iowa, Texas and Oklahoma, respectively, as requisite to qualify said loans, notes and mortgages as valid and subsisting first mortgages in contemplation of such laws. (R. 16)

Interest received by the plaintiff on such farmers' notes and mortgages was not taxable as income to the plaintiff and was not so taxed in respect of plaintiff's return for the year 1922. (R. 16)

Each of said farmers' notes and mortgages contains an agreement providing for the repayment of the loan on the amortization plan as provided in Section 12, Second, of the Federal Farm Loan Act, and such agreement in respect of each note and/or mortgage was such that the respective note and/or mortgage was not extinguished within a period of less than thirty-three years,—except, of course, at the option of the borrower. (R. 16)

In this brief the farmer's "first mortgage note" will be referred to as the "mortgage note" and the farm mortgage (securing the payment of the mortgage note) will be referred to as the "mortgage". Whenever the term "first mortgage" is used it is meant to include and represent both the *mortgage note and the mortgage as a unit* and is used in the sense of the definition in Sec. 2 of the Federal Farm Loan Act, reading:

> "SEC. 2. That wherever the term 'first mortgage' is used in this Act it shall be held to include such classes of first liens on farm lands as shall be approved by the Federal Farm Loan Board, and the credit instruments secured thereby."

If not indicated to the contrary, the italics throughout this brief are ours.

B.

STATEMENT OF QUESTIONS.

The single issue (involving several questions) is whether the indebtedness of a Joint Stock Land Bank evidenced by its Joint Stock Land Bank bonds (the proceeds of which are used to make loans to farmers on farm mortgage security, each loan being made in consideration of the making and delivering by the respective farmer of his mortgage note secured by his farm mortgage, as contemplated and defined in the Federal Farm Loan Act) is indebtedness of the exceptional type designated in the exception clause of Sec. 234 (a) (2) of the Income Tax Law of 1921.

Said Sec. 234 (a) (2) is as follows:

> "SEC. 234 (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * * *
>
> (2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title." (See Appendix, p. 111, for citation.)

This latter clause, beginning with "except on indebtedness", is hereinafter referred to as the "interest deduction exception clause" or simply the "exception clause".

It should be observed parenthetically at this juncture that the interest received on the farmers' first mortgages is not taxable as income to the Joint Stock Land Banks. Sec. 26 of the Federal Farm Loan Act (Act of Cong. July 17, 1916, c. 245, 39 Stat. 360) makes specific provision in this respect as follows:

> "First mortgages executed to Federal land banks,

> or to Joint Stock Land Banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, Municipal and local taxation."

Reverting to the exception clause,—an initial inquiry is whether, apart from the literal wording of the exception clause, such indebtedness of a Joint Stock Land Bank falls within the spirit and intended scope of the exception clause,—in view of the Congressional purpose in adopting the exception clause.

If the issue be viewed as turning rather on the literal wording of the exception clause interpreted in the light of its intended scope, three questions present themselves.

The first question, which if answered in the negative disposes of the issue at the threshold, is whether such indebtedness of a Joint Stock Land Bank is "incurred or continued to purchase or carry" the farmers' first mortgages, or, in fact, anything whatsoever.

The second question, which in common with the third question is material only in the event the first question is answered in the affirmative, is whether the farmers' first mortgages are "obligations or securities the interest upon which is wholly exempt from taxation under this title",—to wit, Title II of the Revenue Act of 1921,—the Income Tax Law of 1921.

Sec. 213 (b) (4) of said Title II of the Revenue Act of 1921, which is hereafter sometimes referred to as the "interest exemption section" or simply the "exemption section", is as follows:

> "SEC. 213. That for the purposes of this title (except as otherwise provided in Section 233) the term 'gross income', (b) Does not include the following items, which shall be exempt from taxation under this title: (4) *Interest upon* (a) the obligations of a

State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) *securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if, and to the extent it is wholly exempt to the taxpayer from income, war profits and excess profits taxes."

The Court of Claims, withdrawing its original opinion to the effect that the interest paid by a Joint Stock Land Bank on such bonds was not within the intended scope of the exception clause, answered both the first and second questions (erroneously in each respect, it is submitted) in the affirmative, as follows:

> "We are of the opinion that the notes and first mortgages owned and held by joint-stock land banks, and used by them as collateral security for the payment of their bonds, are *securities under* the provisions of the Federal farm loan act of 1916, and that as such the interest upon them is specifically exempted from taxation under section 213 (b) (4) of the revenue act of 1921. It follows that under the provisions of section 234 (a) (2) of that act the interest paid by joint-stock land banks on their farm loan bonds, which *is indebtedness incurred, and continued to purchase and carry such securities*, comes within the exception and is not deductible from income." (R. 26)

The third question, which in common with the second question involves the meaning of the exception clause phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title", arises

out of the defendant's alternative interpretation of such phrase, viz.: that, even if the farmers' first mortgages do not fall within Sec. 213 (b) (4) (b) as "securities issued under the provisions of the Federal Farm Loan Act" and consequently are not "obligations or securities the interest upon which is wholly exempt from taxation under this title" (to wit, the Income Tax Law of 1921), such first mortgages fall within "obligations or securities • • • the interest upon which is wholly exempt from taxation under this title" by virtue of the exemption of interest thereon contained in Sec. 26 of the Federal Farm Loan Act. This question is not answered in the opinion and decision of the Court of Claims, but is considered under II C 2 (b) *infra* p. 72.

The plaintiff collaterally presented to the Court of Claims for its consideration the decision in the case of *Nauts* v. *Slayton*, 36 Fed. (2d) 145, (decided December 6, 1929), now before this Court by virtue of a Writ of Certiorari, and urged, in the light of principles of construction laid down by this Court in *National Life Insurance Co.* v. *United States*, 277 U. S. 508 (II E *infra* p. 96), that the interest deduction exception clause, aside from considerations of the intended scope or literal wording thereof, may not be applicable to such indebtedness of Joint Stock Land Banks. This contention of the plaintiff was not mentioned in the opinion and decision of the Court of Claims.

C.

ERRORS TO BE URGED.

It is submitted that the Court of Claims erred

(1) in holding that the interest paid by a Joint Stock Land Bank on such indebtedness evidenced by its bonds is within the intended scope of the interest deduction exception clause of Sec. 234 (a) (2); (Argument *infra* II A 1 p. 14; II A 2 p. 14; and II B p. 28)

(2) in rejecting the Congressional designation in respect of the purpose for which such indebtedness of a Joint Stock Land Bank is incurred, to wit, "for carrying on the business of *lending* on farm mortgage security"; (Argument *infra* II A 3 (a) p. 16, II C 1 (a) p. 35, and (b) p. 37)

(3) in holding that such indebtedness of a Joint Stock Land Bank on its bonds is incurred "to purchase or carry" farmers' first mortgages,—in contemplation of the interest deduction exception clause; (Argument *infra* II A 3 (b) p. 19, and II C 1 (c) p. 38)

(4) in holding that the farmers' mortgage notes and/or mortgages are "obligations or securities • • • the interest upon which is wholly exempt from taxation under this title" (viz.: the Income Tax Law of 1921) by virtue of the exemption contained in Sec. 213 (b) (4) (b) thereof, which exempts "interest upon" "*securities issued under the provisions of the Federal Farm Loan Act*", or, in other words, in holding that the farmers' first mortgages fall within the scope of "securities issued under the provisions of the Federal Farm Loan Act." (Argument *infra* II A 3 (d) p. 23, and II C 2 (a) p. 52)

(5) in extending the interest deduction exception clause, "by implication beyond the clear import of the language used" and enlarging "its operation so as to embrace matters not specifically pointed out"; (Argument *infra* II D p. 79)

(6) and in applying the interest deduction exception clause to such indebtedness of a Joint Stock

Land Bank evidenced by its bonds in view of the decision in respect of the constitutionality of the clause in the case of *Nauts* v. *Slayton* and the rules of construction laid down by this Court in *National Life Insurance Co.* v. *United States.* (Argument *infra* II E p. 96)

II.

ARGUMENT.

SUMMARY.

The following is a skeleton summary, with caption refferences, of the plaintiff's argument:

In view of the purpose in mind, Congress limited the interest deduction exception clause to a definitely circumscribed type of indebtedness and the Congressional intent in such respects is an essential guide in construing not only the spirit and intended scope but also the letter of the clause (A *infra* p. 14).

The indebtedness of a Joint Stock Land Bank evidenced by its bonds, issued to create a fund to make and out of which are made loans tc farmers on farm mortgage security, as contemplated in the Federal Farm Loan Act, is not, in view of the Congressional purpose in authorizing Joint Stock Land Banks as evidenced in the Federal Farm Loan Act, within the *spirit or intended scope* of the interest deduction exception clause (B *infra* p. 28).

Such indebtedness of a Joint Stock Land Bank is not within the *letter* of the interest deduction exception clause (a) in that, in the first place, the purpose of such indebtedness is not "to purchase or carry" anything whatsoever (A 3 (a) *infra* p. 16 and C 1 (a) *infra* p. 35) and, in the second place, the incidental acquisition of the farmer's mortgage note and mortgage (in connection with the mortgage loan) does not transmute the original purpose into (C 1 (b) *infra* p. 37) or involve (A 3 (b) *infra* p. 19 and C 1 (c) *infra* p. 38) a "purchase or carry" as such phrase is used in the interest deduction exception clause and, consequently, at the threshold and without reference to other sections of the Income Tax Law or the Federal Farm Loan Act,

such indebtedness is not of the type specified in the interest deduction exception clause; and (b) in that, even assuming for the argument that such indebtedness of a Joint Stock Land Bank is incurred to "purchase or carry" the farmers' first mortgages, such first mortgages are not "obligations or securities the interest upon which is wholly exempt from taxation under this title" in that, in the first place, the only conceivably applicable exemption "under this title" is that of Sec. 213 (b) (4) (b) and farmers' first mortgages do not fall within "securities issued under the provisions of the Federal Farm Loan Act" (A 3 d *infra* p. 23 and C 2 (a) *infra* p. 52) and, in the second place, the interest exemption extended under Sec. 26 of the Federal Farm Loan Act to "first mortgages executed to" Joint Stock Land Banks does not transform such first mortgages into "obligations or securities the interest upon which is wholly exempt from taxation under this title", as specified in the interest deduction exception clause of the Income Tax Law (C 2 (b) *infra* p. 72).

In view of the above a holding that such indebtedness of a Joint Stock Land Bank falls within the interest deduction exception clause requires an extension of such clause "by implication beyond the clear import of the language used" and an enlargement of "its operations so as to embrace matters not specifically pointed out", which is contrary to the rules laid down by this Court for the interpretation of statutes levying taxes (D *infra* p. 79).

Irrespective of the intended scope or letter of the interest deduction exception clause, its application to such indebtedness of Joint Stock Land Banks is seriously to be questioned in view of the decision in respect of constitutionality in the case of *Nauts* v. *Slayton* and the rules of construction laid down by this Court in *National Life Insurance Co.* v. *United States* (E *infra* p. 96).

A.

IN ADOPTING THE INTEREST DEDUCTION EXCEPTION CLAUSE CONGRESS HAD A DEFINITE PURPOSE AND IN CONTEMPLATION THEREOF FIXED A DEFINITE LIMIT TO THE SCOPE OF THIS CLAUSE. THE CONGRESSIONAL INTENT IN THESE RESPECTS IS AN ESSENTIAL GUIDE IN CONSTRUING NOT ONLY THE SPIRIT AND INTENDED SCOPE BUT ALSO THE LETTER OF THE CLAUSE.

1.

INTEREST ON BUSINESS INDEBTEDNESS HAS CONSISTENTLY BEEN DEDUCTIBLE IN DETERMINING NET INCOME UNDER FEDERAL INCOME TAX LAWS.

Beginning with the Income Tax Law of 1913, interest paid on indebtedness has been classified consistently as deductible business expense along with such items as (a) "all the ordinary and necessary expenses • • • in the maintenance and operation of its business and properties, including rentals"; (b) "all losses actually sustained and charged off within the year"; (c) "a reasonable allowance for exhaustion, wear and tear"; and (d) to a limited extent "taxes" (Appendix).

2.

THE EXCEPTION DENYING DEDUCTION OF INTEREST "ON INDEBTEDNESS INCURRED FOR THE PURCHASE OF OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE" (IN THE 1917 AND SUBSEQUENT ACTS) WAS AIMED AT THE TAXPAYERS' PRACTICE OF BORROWING MONEY TO PURCHASE A SPECIFIED CLASS OF TAX EXEMPT SECURITIES, THEREBY GETTING THE BENEFIT OF THE EXEMPTION OF THE INTEREST RECEIVED AND THE DEDUCTION OF THE INTEREST PAID ON THE INDEBTEDNESS SO INCURRED.

In the Majority Report of the Committee on Finance of the Senate (65th Cong. 3d Session—Senate Report No.

617, December 8, 1918, at p. 6) submitted in connection with the 1918 Income Tax Law, is the following statement:

"DEDUCTIONS.

The interest deduction (sec. 214, a, 2, and sec. 234 a, 2), has been amended so as not to permit a deduction for interest on indebtedness incurred or continued to purchase or carry tax-free securities other than obligations of the United States issued after September 24, 1917. *This limitation is substantially the same as the one contained in the present law.* The provisions of the House Bill which allow a deduction for interest on all indebtedness permits the taxpayer to make loans *for purchases of* wholly exempt securities and then deduct the interest paid on such loans from his otherwise taxable income, thereby reducing his tax. *The limitation suggested above would operate to discourage this practice* except in the case of the latter issues of Liberty Bonds."

In other words the intent of Congress was to accomplish a definite purpose, that is, to discourage a practice adopted by taxpayers to reduce their taxes.

The immediate purpose of the exception to interest deduction was to forestall deliberate tax avoidance in view of the high surtax rate and the ever increasing amount of tax exempt securities *readily purchasable in the open market.* The Secretary of the Treasury, in his annual report to the Congress dated December 6, 1922, recommended that the highest surtax be reduced from fifty per cent to twenty-five per cent. He also stated that fully tax exempt securities then aggregated about $11,000,000,000 and that they were increasing at about the rate of $1,000,000,000 a year. (Preface, "Income Tax Procedure," *infra.*)

Robert H. Montgomery in his book "Income Tax Procedure, 1923" in reference to the interest deduction exception clause says, at p. 869:

"The restriction on the deduction is sound. It

was made imperative by the establishment of very high income tax rates. So long as the rates of the tax were low, there was no appreciable inducement to a taxpayer to borrow money with which to buy tax-exempt securities. Under very high surtax rates the situation changed. Without this restriction taxpayers subject to high rates would find it profitable *to buy tax-exempt securities on a large scale with borrowed money*, using the interest on such borrowings as a deduction from taxable income from other sources."

3.

BY ITS EXPRESS LANGUAGE THE EXCEPTION CLAUSE DENIES DEDUCTION OF INTEREST IN RESPECT ONLY OF INDEBTEDNESS INCURRED OR CONTINUED WITH (A) THE PURPOSE (AND SO USED) (B) TO PURCHASE OR CARRY (C) NOT TAX EXEMPT SECURITIES OR OBLIGATIONS IN GENERAL, BUT (D) A SPECIFIED CLASS OF "OBLIGATIONS OR SECURITIES," TO WIT, THOSE THE "INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE,"—CONGRESS HAVING, IN SECTION 213 (B) (4), SPECIFIED OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS "EXEMPT FROM TAXATION UNDER THIS TITLE."

Congress, having in mind a specific purpose, definitely limited the scope of the interest deduction exception clause to a *definitely circumscribed type of indebtedness.*

(a)

PURPOSE OF THE INDEBTEDNESS.

In the first place, the indebtedness must have been incurred or continued with the *purpose* to purchase or carry the specified exempt securities.

As an illustration, in Solicitor's Recommendation 5128, IV-2, C. B. 156, it is stated:

"Interest paid by the taxpayer on amounts credited to its customers for products sold on consign-

ment basis, such amounts being left on deposit with the taxpayer and used at various times to purchase municipal and State bonds, is not interest paid on indebtedness incurred to purchase securities, the interest upon which is exempt from tax.

It is the opinion of this office, (Solicitor of Internal Revenue), that interest paid on amounts credited to the taxpayer's clients is interest paid on indebtedness within the meaning of Section 234 (a) 2 of the Revenue Acts of 1918 and 1921 (I. T. 2028, C. B. III-1, 296), and is an allowable deduction from gross income. It can not be said that indebtedness incurred by reason of such credits is incurred to purchase or carry tax-exempt securities. In this respect the taxpayer's business is in the nature of banking, and in the case of a bank indebtedness incurred by reason of deposits which are invested in tax-exempt securities is not incurred to purchase or carry such securities.

It is, therefore, recommended that the protest of the taxpayer in this case be sustained and the action of the Income Tax Unit be modified in accordance with the above opinion."

Incidentally, this ruling indicates clearly that the mere casual coincidence of exemption of interest on securities held and deduction of interest on indebtedness incurred does not stigmatize the indebtedness as "indebtedness incurred to purchase or carry securities or obligations the interest upon which is wholly exempt from taxation under this title".

Again in Office Decision of the Income Tax Unit, 1213, I-1, C. B. 132, construing the exception clause of the Revenue Act of 1921 (now at issue), it is said:

"The interest paid on a loan which a taxpayer was obliged to continue in order to cover losses sustained on the sale of Liberty Bonds is an allowable deduction from gross income under the provisions of Section 234 (a) (2) of the Revenue Act of 1921. Likewise, *interest paid on a loan made to pay city taxes, Liberty bonds being deposited as security* for the loan, *is deductible* for income tax purposes."

Here is manifested a very strict attitude against extension of the exception clause. It should be noted that such was not a *carry* of the Liberty Bonds. The fact that the loan was made, with Liberty Bonds merely as security, to pay city taxes, took it out of the clause. The purpose of the indebtedness is controlling. Here again is a clear indication that the mere casual coincidence of exemption of interest on securities held and deduction of interest on indebtedness incurred, does not stigmatize the indebtedness as "indebtedness incurred to purchase or carry securities or obligations the interest upon which is wholly exempt from taxation under this title".

Again (Income Tax Procedure, 1923, Montgomery, at p. 687) we find the following:

> "It is the ruling of this office that a bank doing a commercial business and receiving deposits upon which it pays interest is entitled to deduct from its gross income shown upon its annual tax return the full amount of interest paid to its depositors. The payment of such interest is one of the ordinary and necessary expenses in the carrying on of its business. Although the deposits constitute indebtedness of the bank, such indebtedness was not incurred and is not continued for the purpose of purchasing or carrying obligations, even though the deposits are invested in bonds or other obligations the interest upon which is wholly exempt from income and excess profits tax. (Letter to Lybrand, Ross Bros. & Montgomery, signed by Commissioner Roper, June 24, 1919.)"

Here again the casual coincidence of exemption of interest on securities held and deduction of interest on indebtedness incurred, does not stigmatize the indebtedness as "indebtedness incurred to purchase or carry securities or obligations the interest upon which is wholly exempt from taxation under this title".

The rulings and decisions cited above indicate clearly

that the occasion (purpose) of the incurring or continuing of the indebtedness may take the indebtedness out of the exception clause, irrespective of the use of the proceeds of the indebtedness "to purchase or carry" any of the obligations specified in the exception clause. The exception clause embraces only such indebtedness as has two qualities, to wit, one, of being incurred or continued with an immediate and express purpose "to purchase or carry" one of the specified obligations and, second, its proceeds must be used "to purchase or carry" one of the specified obligations. Of course, if the proceeds are not used "to purchase or carry" one of the specified obligations the mere purpose of the incurring or continuing of the indebtedness is of no consequence.

(b).

"TO PURCHASE OR CARRY."

It seems unnecessary to discuss at length the definition of the word "purchase" as used in the exception clause. Considering the purpose, subject matter and context of the clause, "purchase" obviously means "buy for money or money equivalent" with possibly but not necessarily an inference of simultaneous cash payment out of the proceeds of the borrowing.

The true meaning of the word "carry" as used in the exception clause is not so immediately obvious. The initial inquiry is whether the word "carry" is supplemental to the word "purchase", or whether it introduces a new act entirely unassociated with "purchase", and, if so, what act.

As we have seen, the Income Tax Unit has (at least heretofore) apparently construed and restricted the exception clause to indebtedness having some relation to the purchase of the specified securities. It clearly has

not adopted any general definition of the word "carry", —unrelated to a purchase. For example, in Office Decision 1213 (*supra*, p. 17) it was held that "interest paid on a loan which a taxpayer was obliged to continue in order to cover losses sustained on a *sale* of Liberty bonds is an allowable deduction under the exception clause. Furthermore, interest paid on a loan made *to pay city taxes*, Liberty bonds being deposited as security, is likewise deductible." In the latter case, although the indebtedness was incurred clearly "to bear the charges or burden of holding" the Liberty bonds (as distinguished from selling them to raise the tax money) the indebtedness was not incurred to "carry" the exempt Liberty bonds. In other words, the indebtedness was incurred and used *to pay city taxes* and was, therefore, not incurred to "purchase" the Liberty bonds and it was not incurred "to carry" the Liberty bonds because the indebtedness has no relation to the purchase (past or present) of the Liberty bonds or the payment therefor.

The soundness of this construction is clearly borne out by the history of the language of the phrase "to purchase or carry". The original interest deduction exception clause in the 1917 Act (See Appendix, Sec. 1207) reads "except on indebtedness *incurred for the purchase* of obligations, etc.". This language was extended in the 1918 Act (See Appendix, Sec. 234 (a) (2)) to read "except on indebtedness *incurred or continued to purchase or carry* obligations, etc.". Apparently the words "continued" and "carry" were added to make clear the full intent of the original clause ("indebtedness incurred for the purchase") so as to eliminate captious argument that indebtedness *continued* to *"purchase"* was not indebtedness *incurred* to "purchase" or that indebtedness incurred to *"carry"* a purchase was not indebtedness incurred to *purchase*. In other words, even though the

indebtedness is incurred six months before the actual purchase, and even for another purpose, it is, if *continued* in order to purchase, *incurred for the purchase*, or, on the other hand, if the particular security is purchased first and then indebtedness is subsequently incurred or continued to pay the price promised at the time of purchase, *i. e.*, to *carry* the purchase, such is an *"indebtedness for the purchase"*. To put it another way, the word "continued" after "incurred" and the word "carry" after "purchase" have a parenthetical aspect and relate back to the preceding words, respectively, with a view of making clear the Congressional intent that the order in time of the incurring of the indebtedness, on one hand, and the purchase of the securities, on the other hand, is inconsequential,—the essential feature being that the proceeds of the indebtedness are used to pay the price of *a "purchase"*.

This apparently obvious purpose of the addition of the words *"continued"* and *"carry"* in the 1918 Act is abundantly confirmed in the Finance Committee Report in respect of the 1918 Act (quoted above at page 15) to the effect that *"this limitation is substantially the same as the one contained in the present law"*, to wit, the 1917 Act, which referred only to "purchase".

Again, it will be noted that the Senate Committee on Finance, in reporting the 1918 law, which for the first time added the words "to carry", still refers to the making of loans "for purchases of" tax exempt securities (*supra*, p. 15).

Furthermore, in the financial world one is said to carry a security when he borrows money and uses it to pay the purchase price of the security purchased by him,—in other words, he borrows to "carry" his purchase. The word "carry" is not a word of art and has no accepted legal significance, so it is not reasonably to

be assumed that Congress, in view of the context, used "carry" in any different or broader sense than it is used in fiancial transactions of the kind under consideration.

Thus it appears that previous rulings of the Income Tax Unit, the legislative history of the language of the phrase "to purchase or carry", and the sense of "to carry" in financial transactions of the kind under consideration, are in agreement to the effect that the word "carry" in the phrase "to purchase or carry" merely supplementally defines the word "purchase" and, further, to the effect that a "carry" within the exception clause must be predicated on and presupposes a "purchase" of securities of the type specified in the exception clause.

In fact, considering the context, it is difficult to conjure up any situation or transaction which would give to the word "carry" any significance disassociated completely from the purchase of securities or the payment of the purchase price in respect of a purchase of such securities. Considering the purpose and context of the exception clause, to what purpose would a borrower incur indebtedness other than in some connection with a purchase of such securities?

(c)

NOT TAX EXEMPT SECURITIES OR OBLIGATIONS IN GENERAL.

The denial of interest deduction was not aimed at the purchase of any and all securities tax exempt as to income.

In the Appeal of *Greenville Textile Supply Co.*, Dec. 66, 1 B. T. A. 152, subsequently acquiesced in by the

Commissioner of Internal Revenue, it was held on appeal of the taxpayer that:

> "Interest paid or accrued by a corporation within the taxable year on its indebtedness incurred or continued to purchase or carry stock in a domestic corporation, where the dividends are exempt from tax, is an allowable deduction, since the stock does not come within the terms 'obligations or securities, the interest upon which is exempt from taxation'. In order to disallow the deduction, it is not only necessary to construe the word 'securities' to mean 'stock' but to construe the word 'interest' to mean 'dividends.'"

It will be noted that there is a suggestion by the Board of Tax Appeals that the word "securities" has a limited application in contemplation of the full context of the exception clause rather than an independent meaning as an isolated word.

Congress, obviously, was not attempting to circumvent every coincidence of interest deduction and income exemption but aimed to defeat interest deduction in respect of indebtedness incurred to purchase or carry only a specific class of securities or obligations.

(d)

A SPECIFIED CLASS OF "OBLIGATIONS OR SECURITIES".

The denial of interest deduction was aimed against indebtedness incurred to purchase or carry a specified class of securities, to wit, "obligations or securities the interest upon which is wholly exempt from taxation under this title",—not against indebtedness incurred to purchase or carry "securities", or "obligations", or "interest bearing obligations", or "tax exempt securities or obligations", or "tax exempt interest bearing obligations" or "securities or obligations in whole or in part exempt from income tax", but, specifically, against

indebtedness incurred to purchase or carry *"obligations or securities the interest upon which is wholly exempt from taxation under this title"*.

Any proper interpretation of the exception clause requires, therefore, that the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" must be construed as a unit and not as a series of unassociated words.

Section 213 (b) (4) of Title II of the Revenue Act of 1921 (see Appendix) expressly designates the obligations or securities the interest upon which is "exempt from taxation under this title" (incidentally, indicating where the exemption is only partial) as follows:

> "(a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war profits and excess profits taxes."

Furthermore, Congress, in drafting the original exception clause (Act of 1917) borrowed the words "obligations", "or", "securities", and "interest upon" from the exemption section. When the exception clause was formulated, the interest exemption section exempted only *"obligations"* and *"securities"*, and the exception clause adopted the verbiage of the exemption section and used the two words in the very order they appear in the

exemption section, to wit, obligations first, and securities second.

The obligations or securities designated in the interest exemption section (Section 213 (b) (4)) are obligations of the Government, such as United States Treasury Bonds, Treasury Notes, Treasury (war) Savings Certificates, Liberty Bond Issues, Victory Liberty Loan Convertible Notes, also obligations of States, Territories and political subdivisions thereof, such as counties, cities and special assessment districts; also obligations of the District of Columbia; also bonds issued by the War Finance Corporation, a Federal agency, and "securities issued under the provisions of the Federal Farm Loan Act". The argument under C. 2, *infra*, p. 52, will, it is submitted, clearly disclose that the latter are the bonds issued by the Federal Land Banks and Federal Joint Stock Land Banks, created under the Federal Farm Loan Act,—said bonds (in contrast to farmers' first mortgages) being of the same category as obligations and securities issued by the United States, States, counties, cities and the War Finance Corporation, and being also in the class of obligations and securities contemplated and specified in the interest deduction exception clause,—being (again in contrast to farmers' first mortgages) available in the market for purchase by taxpayers seeking to get the benefit of interest deduction and interest exemption, against which Congress adopted the interest deduction exception clause.

4.

THE DEFINITE PURPOSE AND CONSEQUENT LIMITED SCOPE OF THE EXCEPTION CLAUSE ARE ESSENTIAL GUIDES IN CONSTRUING NOT ONLY THE SPIRIT AND INTENDED SCOPE BUT ALSO THE LETTER OF THE CLAUSE.

From the previous discussion under this heading it is apparent that in adopting the interest deduction exception clause Congress had a definite purpose. That purpose was not to deny deduction of interest on indebtedness connected generally and indefinitely with the *acquisition or holding of tax-exempt securities* but was a definite and limited purpose to deny interest deduction on indebtedness connected directly with the *buying and paying for a specified class of obligations or securities, i. e.,* it is submitted, those designated in the interest exemption section (Section 213 (b) (4)).

This purpose and the limited scope of the exception clause, in contemplation of that purpose, are essential guides in construing not only the spirit and intended scope but also the letter of the clause.

As said by this Court in *Holy Trinity Church* v. *United States,* 143 U. S. 457, at p. 463:

> "Again, another guide to the meaning of the statute is found in the evil which it is designed to remedy; and for this the Court properly looks at contemporaneous events, the situation as it existed, and as it was pressed upon the attention of the legislative body."

And, further, as said by this Court in *Heydenfeld* v. *Daney, Gold,* etc., 93 U. S. 634, at p. 638:

> "It is true that there are words of present grant in this law; but, in construing it, we are not to look at any single phrase in it, but to its whole scope, in order to arrive at the intention of the makers of it. * * * There is no better way of discovering its true meaning, when expressions in it are ren-

dered ambiguous by their connection with other clauses, than by considering the necessity for it, and the causes which induced its enactment. With these rules as our guide, it is not difficult, we think, to give a true construction to the law under consideration."

Again, as said by this Court in *United States* v. *Union Pacific R. R. Co.*, 91 U. S. 72, at p. 79:

"But courts, in construing a statute, may with propriety recur to the history of the times when it was passed; and this is frequently necessary, in order to ascertain the reason as well as the meaning of particular provisions in it."

B.

THE INDEBTEDNESS OF A JOINT STOCK LAND BANK EVIDENCED BY ITS BONDS, ISSUED TO CREATE A FUND TO MAKE, AND OUT OF WHICH ARE MADE, LOANS TO FARMERS ON FARM MORTGAGE SECURITY IN CONTEMPLATION OF THE FEDERAL FARM LOAN ACT, IS NOT WITHIN THE SPIRIT OR THE INTENDED SCOPE OF THE INTEREST DEDUCTION EXCEPTION CLAUSE.

The distinguishing features of this Joint Stock Land Bank indebtedness will appear from a brief consideration of the origin of Joint Stock Land Banks and of what purpose they were to and do serve.

The Report of the Joint Committee on Rural Credits (64th Congress, 1st Session, House of Representatives, Document No. 494, submitted January 3, 1916), together with a draft of a proposed bill to provide a system of land mortgage credits in the United States under Federal supervision, tells the story as follows:

> "NECESSITY FOR FARM CAPITAL.
>
> The successful farmer becomes more of a business man each year. He must use more machinery, buy more fertilizer, and sow better seed. He must erect better buildings, raise better stock, and grow better crops. He must store his produce in order to sell in a high market. He must pay cash in order to buy cheap. If he wishes to keep his children on the farm, he must make his home attractive. All of this costs money. He must have ready cash."

The report then relates the difficulty a farmer has in securing long-time credits at reasonable interest rates without frequent "substantial renewal fees"; that commercial banks must keep their deposits in short-time loans and are not suited to farmers' long-term needs; that the commercial bank has a valid claim to demand deposits; that this leaves available only savings or time

deposits and money seeking long-term investment; that time deposits are not available for long-term mortgages but there is an abundant supply of money, such as *savings, estate* and *trust funds,* etc., seeking long-term investment under safe conditions, and adds on page 7:

> "INVESTOR AND FARMER BROUGHT TOGETHER FOR MUTUAL PROFIT.
>
> Here we discover the funds that should be made available to the farmers on long-term mortgage. *We may picture the owners of this vast wealth grouped on one side of a river, the farmers desiring loans grouped on the other side.* It is evident that each has what the other wants. We are asked to furnish *the bridge* which shall bring them in touch, or rather to grant a franchise to those who will build the bridge if we will construct the approaches. Such we conceive to be a proper function of the Government."

The report goes on to state the safeguards which shall be thrown around farm loan bonds so as to make them attractive as long-term investments at reasonably low rates of interest; sets forth the machinery for the twelve land banks, relates that farm loan bonds issued by said banks shall be secured by farmers' mortgages; that the land banks are not permitted to charge the farmer borrowers in excess of 1 per cent more of interest than the banks pay out on their bonds; that said mortgage loans to farmers are restricted to certain purposes and must be on farms appraised under Federal supervision, etc.

On page 11, under the heading of "Interest Rates to Farmers", the Committee reports:

> "Present interest rates to farmers are so confused with commissions, fees, and charges of various sorts that it is difficult to ascertain the total cost of money on farm mortgages. Dr. C. W. Thompson, specialist in charge of rural organization in the Department of Agriculture, reports that the average rate varies from 5.3 per cent in New Hampshire to

9 per cent and even 10 per cent in certain Southern and Western States, including commissions. As this is the average rate, there must be individual cases running much higher. Testimony before the joint sub-committees of the Senate and House Committees on Banking and Currency in 1914 gave the maximum rate as high as 25 per cent, including commissions and charges.

It is readily seen that a rate as low as 5 per cent, 5½ per cent, or even 6 per cent would be of great benefit to farmers in most sections of the United States."

The report continues with a recital of how advantageous long-term mortgages would be to the farmers; that the amortization payments over a long period of time relieves pressure in time of financial stress.

On page 14 of the report, the Committee discusses Joint Stock Land Banks in the following language:

"In some localities where land values are settled and farmers are accustomed to borrow from mortgage banks it is quite possible that farmers will prefer to obtain mortgage loans from a joint-stock bank operating under a Federal charter, with Federal restrictions and supervision.

Some farmers, moreover, may object to the association with their neighbors in co-operative undertakings; they may not like the publicity and scrutiny that co-operation entails; they may not be able or willing to subscribe 5 per cent of the face of the desired loan to the stock of the local association. Moreover, associations may start slowly in some States, leaving a wide field unoccupied for years.

Provision is therefore made (sec. 19) for the organization of joint stock land banks of not less than $250,000 capital, to be privately subscribed. Their operations will be confined to a single State, and *they will be permitted to make loans, and to issue farm loan bonds under the supervision of the farm loan board.* Their stockholders will assume double liability. Their capital will be readily available from the outset, and they will thus have certain advantages over co-operative banks in getting their

money out on loans. In order, therefore, to equalize to some extent the earning power of the two classes of banks, they are limited in the issue of bonds to fifteen times their capital and surplus. The co-operative banks may issue bonds to the amount of twenty times their capital and surplus.

Joint-stock land banks are not permitted to engage in any business but making farm mortgage loans and issuing bonds. In States with populations exceeding two millions of people, their capital stock must be not less than $500,000. Their bonds are called joint-stock bonds, and must be in such form as to be readily distinguished from bonds issued by Federal (co-operative) land banks. They are given a free hand as to interest rates on loans and bonds, except that the margin for expense and profit must not exceed 1 per cent a year on the principal of outstanding loans. (sec. 19.)

Provision is thus made for the existence of the three types of mortgage loans. They will be competitors in *granting loans* and in *selling bonds*, but they will all be under strict Government supervision. Each type, in order to survive, must prove its usefulness. Your subcommittee feels that there is a field for all three."

So much for the Committee Report. The Federal Farm Loan Act of 1916 was ultimately passed to serve all these fundamental purposes, and Joint Stock Land Banks were authorized along the lines set forth and for the purposes set forth. It should be noted, however, that in the Act as finally passed, a Joint Stock Land Bank was also given power to engage in operations incidental to carrying on its business of lending to farmers, but was not given "free hand as to interest rates on loans and bonds", but on the contrary a maximum interest rate of 6 per cent on farmers' notes was stipulated with the proviso that within even that restriction the interest rate charged the farmers should not be in excess of 1 per cent over the interest rate of the last issue of the Joint Stock Land Bank bonds issued by the bank. Furthermore, as an essential part of the scheme to get

the loans to the farmers at a low interest rate, Congress expressly, in Sec. 26 of the Federal Farm Loan Act, exempted from income tax the interest received by Joint Stock Land Banks on the farmers' mortgage notes and the interest received by the holder of Joint Stock Land Bank bonds,—the United States absorbing the income tax loss in both instances.

The creation of Joint Stock Land Banks, it was contemplated, would invite private capital available for long-term investment into the farm mortgage field. The original capital of such a bank was to be invested in farm mortgages at a relatively low interest rate for such long-time loans and without any other charge to the farmer, except the expense of verifying title, etc. The farmers' notes and mortgages evidencing such loans (incidentally referred to as "credit instruments" in the Farm Loan Act) were in turn to be pledged with the Federal Registrar as security for the payment of long-term bonds to be issued and sold to the public by the Joint Stock Land Bank. The proceeds of the sale of these bonds, being available for long-term investments, were to be used to *make additional loans to farmers.* The additional notes and mortgages evidencing such additional loans to the farmers were to be used, by way of pledge, as security for the issuance and sale of additional bonds to the public, and the proceeds of said additional bonds were to be used for additional loans to the farmers, etc., etc.

As stated by the Joint Committee in its Report:

> *"Joint Stock Land banks are not permitted to engage in any business but making farm mortgage loans and issuing bonds."*

or as stated by the Attorney General, in discussing the constitutionality of the Farm Loan Act, (31 Op. Atty. Gen., 105):

> "I do not deem it necessary to analyze the Act in

detail. *It is sufficient to say that the mortgages and farm loan bonds are of the very essence of the system created by it.* The original capital of the Federal land banks is to be *loaned,* through the agency of national farm loan associations, to bona fide cultivators of the soil *on first mortgages on farm lands.* When a sufficient amount in such mortgages has accumulated, they are to be turned over to a 'registrar' appointed by the Farm Loan Board, and, with the approval of that board, *farm loan bonds are issued by the land bank and sold.* With the proceeds *further loans* are made on mortgages, which mortgages in their turn become the basis for an *additional issue of bonds. This continuous flow and reflow of mortgages and bonds constitutes the prime functio.i of the whole system.*"

Such was the scheme as contemplated in the Farm Loan Act, and such is the practical working. The Joint Stock Land Bank indebtedness on which interest deduction is claimed herein, is evidenced by bonds having a maturity of thirty years. This is obviously not a temporary borrowing to avoid taxes. The farmers' mortgage notes, respectively, are amortized over a period of not less than thirty-three years (R. 16) and do not bear an interest rate higher than the legal limit of six per cent.

It is submitted that in borrowing money on its bonds to create a fund to make, and out of which are made, loans to farmers, as contemplated by Congress in the Federal Farm Loan Act, a Joint Stock Land Bank is not indulging in the "practice" which the Congress desired to "discourage" when it denied interest deduction in respect of certain indebtedness. In other words, the bank is not borrowing to take advantage of a "practice" which avoided income taxation. On the contrary, in borrowing on its bonds to create a fund to loan money to farmers it is engaging in the primary business contemplated by the Congress. It is also incurring an indebtedness in the ordinary course of business as a busi-

ness expense and in full conformity with the single purpose of its creation. In fact, the first and only specific powers specified in the Charters of the Joint Stock Land Banks (see Appendix) are "to loan money, to issue its bonds".

Clearly, therefore, such indebtedness of a Joint Stock Land Bank is absolutely foreign to the indebtedness refered to in the interest deduction exception clause, and such borrowing of a Joint Stock Land Bank is not within the spirit or the intended scope of the interest deduction exception clause.

The defendant, ignoring considerations in respect of the spirit or intended scope of the interest deduction exception clause, urges that said indebtedness of a Joint Stock Land Bank is within the literal meaning of the interest deduction exception clause. The plaintiff is not unmindful that this Court has rejected literal interpretations because they were not within the intended scope of the statute. For example, in *Holy Trinity Church* v. *United States,* 143 U. S. 457, this Court said, at page 459:

> "It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers" etc.

and again in *Heydenfeld* v. *Daney, Gold etc.,* 93 U. S. 634, at page 638:

> "If a literal interpretation of any part of it would operate unjustly, or lead to absurd results, or be *contrary to the evident meaning of the act taken as a whole,* it should be rejected."

The plaintiff in this case, however, is not confined to a reliance on the above rules of statutory construction because it confidently submits that such indebtedness of a Joint Stock Land Bank is not within even the *letter* of the interest deduction exception clause.

C.

THE INDEBTEDNESS OF A JOINT STOCK LAND BANK EVIDENCED BY ITS BONDS, ISSUED TO CREATE A FUND TO MAKE, AND OUT OF WHICH ARE MADE, LOANS TO FARMERS ON FARM MORTGAGE SECURITY, AS CONTEMPLATED IN THE FEDERAL FARM LOAN ACT, IS NOT WITHIN THE LETTER OF THE INTEREST DEDUCTION EXCEPTION CLAUSE, IN THAT (1) IT IS NOT "INDEBTEDNESS INCURRED OR CONTINUED TO PURCHASE OR CARRY" AND (2) FARMERS' FIRST MORTGAGES, IN ANY EVENT, ARE NOT "OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE".

1.

SUCH INDEBTEDNESS IS NOT "INDEBTEDNESS INCURRED OR CONTINUED TO PURCHASE OR CARRY" IN THAT—

(a)

THE IMMEDIATE AND EXPRESS PURPOSE OF SUCH INDEBTEDNESS, AS WELL AS THE USE TO WHICH THE PROCEEDS THEREOF ARE PUT, IS SIMPLY TO MAKE LOANS TO FARMERS ON MORTGAGE SECURITY AND, CONVERSELY, IS NOT TO "PURCHASE OR CARRY" ANYTHING WHATSOEVER.

As we have seen (*supra*, pp. 16-19), the immediate and express *purpose* for which an indebtedness is incurred, to wit, whether it is to "purchase or carry" the specified obligations or securities, has a fundamental bearing on whether such indebtedness falls within the meaning of the interest deduction exception clause. The immediate and express purpose of a Joint Stock Land Bank in incurring such indebtedness by borrowing on its bonds is simply to create a fund which may be loaned to farmers on farm mortgage security in consideration in each case of the making and delivery by the borrowing farmer of his first mortgage (note and mortgage). Congress itself, in the Federal Farm Loan

Act (Section 16), expressed this purpose in the following language:

> "That corporations, to be known as joint stock land banks, for carrying on the business *of lending* on farm mortgage security and *issuing farm loan bonds,* may be formed by any number of natural persons not less than ten."

The Joint Congressional Committee, in reporting the Federal Farm Loan Act to Congress (*supra,* p. 30), expressed the purpose as follows:

> "They will be permitted *to make loans,* and to issue farm loan bonds under the supervision of the farm loan board."

The Attorney General (*supra,* p. 33) expressed the purpose in the following language:

> "With the proceeds (of farm loan bonds issued and sold by the banks) *further loans* are made on mortgages."

The charters of the said two Joint Stock Land Banks, respectively (see Appendix), read "said bank is hereby granted authority and power *to loan money,* issue its bonds, and to do all other things etc.".

Furthermore, the inclusion of "loan" in the title "Federal Farm Loan Act" and also the title "Federal Farm Loan Board" confirms the Congressional view of the purpose and nature of the primary function of the Federal Land Banks and Joint Stock Land Banks in respect of their first mortgage operations. The Federal Farm Loan Act is replete with words and phrases which proclaim that such indebtedness is incurred and in fact authorized for the fundamental purpose of making loans.

It is submitted, therefore, that the purpose of such indebtedness as expressed by Congress in the Farm Loan Act, by the Joint Congressional Committee, by the Attorney General and the banks' charters should

be accepted as conclusive of the Congressional intent in determining whether the purpose of such indebtedness falls within the purpose of the indebtedness specified, immediately subsequent in point of time, by Congress in the interest deduction exception clause. If so accepted, such indebtedness of a Joint Stock Land Bank is not within the purpose expressed in the interest deduction exception clause and, therefore, is at the very threshold not within the letter of the interest deduction exception clause.

A Joint Stock Land Bank, in making such loans, obviously and concededly uses the proceeds of such indebtedness in conformity with the purpose for which it incurred it. In respect of both purpose and use of proceeds thereof, such indebtedness of a Joint Stock Land Bank does not fall within "indebtedness incurred or continued to purchase or carry".

(b)

THE ACQUISITION OF THE FARMER'S FIRST MORTGAGE IS MERELY INCIDENTAL TO THE MAKING OF THE LOAN AND DOES NOT TRANSMUTE THE PURPOSE OF SUCH INDEBTEDNESS OR THE USE OF THE PROCEEDS THEREOF INTO THAT OF "PURCHASE OR CARRY".

It is true that in making a loan to a farmer a Joint Stock Land Bank incidentally acquires, as contemplated in the Federal Farm Loan Act, a first mortgage on the borrowing farmer's farm. It is also true that a Joint Stock Land Bank (to the extent that proceeds of bonds are loaned to farmers) incurs such indebtedness on its bonds and uses the proceeds thereof with a view to the incidental acquisition of the farmer's first mortgage. These circumstances, however, it is submitted, do not transform the purpose of the indebtedness or the use of the proceeds into a purpose or use of proceeds "to

purchase or carry". The purpose and use of the proceeds, as indicated by the Congress itself, remains as before, to wit, to make loans to farmers on mortgage security.

(c)

EVEN THE INCIDENTAL ACQUISITION OF THE FARMER'S FIRST MORTGAGE DOES NOT INVOLVE A "PURCHASE OR CARRY" AS SUCH WORDS ARE USED IN THE INTEREST DEDUCTION EXCEPTION CLAUSE.

Assuming that the purpose of such indebtedness and the use of the proceeds thereof may be said to be to acquire the farmer's first mortgage, such acquisition does not involve a "purchase or carry" of the first mortgage within the clear and plain meaning of the words "purchase or carry" as such words were deliberately used by Congress in building up the phrase "indebtedness incurred or continued to purchase or carry".

By way of preliminary comment, plaintiff submits that the issue herein turns primarily on whether the indebtedness at issue is of the type of "indebtedness" which Congress identified by the phrase "indebtedness incurred or continued to purchase or carry" specified obligations; that such phrase must be considered as a unit; and that the identification of the "indebtedness" is not expedited or proved by considering the phrase "incurred or continued" as divorced from the phrase "to purchase or carry" and vice versa, or by considering the word "continued" as divorced from "incurred" or the word "carry" as divorced from "purchase",—particularly when there is clear manifestation of Congressional intent that the phrase has a meaning as a unit. Treating the phrase "incurred or continued to purchase or carry" as a group of isolated words (attributing unrelated meaning and significance to each) not only makes

any identification difficult but also entails considerable discussion to show that the words, even if considered independently, do not fit together and into the Congressional intent unless they are given the meaning and significance which the context of the whole phrase would originally attribute to them.

The defendant proposed below and the Court of Claims, disclaiming any intent to apply technical meanings different from that in which the word is "ordinarily used", adopted (R. 21, 22) numerous unrelated definitions and synonyms of the word purchase and the word carry, culled at random to illustrate the respective meanings of these words in general or in the various branches of the law (including statutes). Furthermore, the Court of Claims (R. 22), relying *en masse* on these numerous unrelated definitions and synonyms and without specification, states that "the words *purchase* or *carry* in our opinion, are apt words and characterize *precisely* the *acquisition* of and the *holding* of farmers' notes and mortgages by joint-stock land banks". This statement involves in its double aspect the meaning of "purchase or carry" and the nature of the transaction involved in a Joint Stock Land Bank's acquisition of a farmer's first mortgage. Passing the latter for the moment, let us note what meaning the Court of Claims attributed to the phrase "to purchase or carry".

As to the word "purchase",—it is submitted that, with the exception of one definition, the definitions and synonyms adopted by the Court of Claims (R. 21) are foreign to and do not reflect in any precise or exclusive sense the meaning of the word "purchase" as used in the exception clause. Technical definitions such as

> "Law: Technically, to acquire (real estate) by any means whatever other than descent or inheritance."

and the broad legal definition:

> "The term 'purchase' in its general signification, and which is the legal sense of it, includes all modes of acquiring property except by descent, and it embraces a devise." *McCartee* v. *Orphans' Asylum*, (N. Y.) 9 Cow. 437.

and the definitions in respect of special branches of the law, such as that of negotiable instruments, to wit:

> "The payee of a note is the purchaser thereof, if he advances money or otherwise parts with valuable consideration therefor." 8 C. J. 468, 469, 470.

and the definition:

> "Law: (1) To acquire (property) by one's own act or agreement, as distinguished from the act or mere operation of law."

and the synonyms:

> "Acquire; bargain for; barter for; get; obtain; procure; secure."

quoted by the Court of Claims are, it is submitted, irrelevant to the thought Congress was expressing in the interest deduction exception clause and add nothing to a complete and sufficient expression of the thought Congress had in mind in adopting the word "purchase". In fact, if these technical, general, special and random definitions and synonyms are to be adopted as expressing the Congressional intent, it would impute to the Congressional mind either a strange confusion or an inability to express itself.

The definition—

> "Purchase: To obtain or secure as one's own by paying or promising to pay a price",

subject to the mental reservations that the property is acquired in a transaction of buying and that the price is money or money equivalent, is an acceptable equivalent of "purchase" of the exception clause,—otherwise not. Moreover, this definition, if its scope is not reduced by and within the limits of such mental reservations,

would not be the equivalent of "to purchase" because it would embrace acquisitions of property in transactions foreign to those of *purchase*, such as an acquisition of property in a transaction of *lending* on the security of such property. Incidentally, this definition recognizes that the price in respect of a purchase may be payable either at the time of purchase or subsequent thereto, and recalls the ostensible Congressional intent in adding in the 1918 Act the word "carry",—to indicate that indebtedness incurred or continued subsequent to the purchase, to pay the price promised at the time of purchase, is "indebtedness incurred *for the purchase of*" (*supra*, p. 21).

"Buying for money" (plus possibly but not necessarily the inference of payment at time of purchase) found in the remaining group of definitions adopted by the Court of Claims, to wit:

> "(3) To obtain (anything) by paying money or its equivalent; the acquisition of title to, or property in, anything for a price; *buying for money* or its equivalent."

reflects the plain and unadorned sense of the word "purchase" in the exception clause (A 3 (b) *supra*, p. 19). The other definitions in this group are, on the one hand, too broad as definitions of "purchase" in that they would include the acquisition of property by barter, rental for cash consideration, etc., and, on the other hand, are deficient in that they lack the connotation of "buying".

The plaintiff, submitting that a determination of the meaning of "to purchase" in the exception clause does not require reference to definitions or synonyms of the word purchase, points out that Webster's New International Dictionary (1929), although it sets forth numerous unrelated meanings of purchase (the transitive verb)

under six separate numerical headings, offers only one comment under the symbol "Syn.," which is—"See Buy." Turning to "Buy" we find, immediately following the symbol "Syn." the following:

> "Buy, Purchase are in meaning convertible terms."

and yet the Court of Claims (R. 22) infers that the plaintiff, in submitting that "to purchase" means "to buy for money or money equivalent" is proposing a "technical meaning different from that in which" it is "ordinarily used".

As to "carry",—it is submitted that all the definitions of the word carry adopted by the Court of Claims (R. 21-22) are foreign to the meaning of "carry" as used in the exception clause. Obviously a Joint Stock Land Bank does not borrow in respect of a farmer's first mortgage "to advance the money to pay his interest". We have seen (*supra*, p. 20) that the Income Tax Unit has not adopted the second definition, to wit, "to bear the charges or burden of *holding*" as distinguished from the burden of *purchase*. Likewise, the definition "to keep on one's books as a debtor" has the inference that the debt is past due, which inference, of course, is not present in the farmer's qualified first mortgage, which is and must be, in good standing. The final group of synonyms lacks the element of borrowing money to bear charges incident to a *purchase*. (A 3 (b) *supra*, p. 19.)

The Court of Claims not only substituted the general word "acquisition" as the equivalent of "purchase" but also adopted "holding" from a final group of synonyms (to wit, "to keep on hand; maintain; keep up; support; hold") as the equivalent of "carry".

If it be proposed that "carry" means "to keep on hand" or "hold" and signifies generally the act of "holding", divorced from any inference of bearing the

burden of acquisition and also divorced from any relation to the mode of acquiring possession (such as the burden of carrying the cost of acquisition by purchase) it rests, it is submitted, on the one proposing such meaning to justify the application of such meaning to the transaction Congress had in mind in adopting the exception clause.

Furthermore, if it be proposed that "carry", in some indefinite sense of "maintain; keep up; support", signifies the bearing of some indefinite burden incident to the mere possession of one of the specified securities and unrelated to the acquiring of such possession (as distinguished from bearing the burden of the cost of acquisition, *i. e.*, the purchase price, of one of the specified securities acquired by purchase,—either prior to or subsequent to the time the indebtedness is incurred or continued), it rests, it is submitted, on the proposer of such meaning to specify not only the nature of such burden but also to justify the application of such meaning to the transaction Congress had in mind in adopting the exception clause.

In the last analysis,—Congress originally in the 1917 Act used the single word "purchase" and in the 1918 and subsequent Acts substituted in lieu thereof, as being "substantially the same", the phrase "to purchase or carry", which is quite sufficient to express the Congressional intent in view of the purpose of the exception clause,—to wit, to deny the deduction of interest on indebtedness incurred or continued to provide the funds required to make or carry a purchase of the specified interest exempt securities. If this phrase is to be broken down and the words given independent unrelated meanings, or if the meaning of these words, jointly or independently, is to be extended beyond "the clear import of the language used", or beyond any direct meaning

necessary to the full purpose of the context, so as to mean "to acquire" (as distinguished from "to acquire by purchase"), "to bargain for", "to barter for", "to obtain", "to acquire by devise", "to carry" (as distinguished from "to carry" a purchase), "to hold", "to bear", "to keep on hand", "to maintain", "to support", the double burden of specifying the application of any such meanings and of reconciling such meanings with some Congressional intent would seem to fall on the one proposing such meanings (see *Gould* v. *Gould, infra,* p. 79).

Considering (a) the Congressional purpose (II A 2 *supra,* p. 14), (b) the rulings of the Internal Revenue Bureau, (c) the historical development of the phrase "to purchase or carry", and (d) the meaning of "carry" in financial parlance (II A 3 (b) *supra,* p. 19), it is submitted that the word "carry" (in common with "purchase") inescapably denotes an act in some manner connected with an acquisition by purchase of such specified obligations or securities and that, therefore, "carry" is predicated on and presupposes a purchase. In other words, it is submitted, unless the indebtedness has some relation to a purchase it is not *incurred or continued "to purchase or carry".*

It remains, therefore, to apply the facts to the law and determine whether a Joint Stock Land Bank's acquisition of a farmer's first mortgage involves, under the circumstances of the acquisition, a purchase of the first mortgage.

In acquiring a farmer's first mortgage (*i. e.* mortgage note and mortgage) at the time of inception, incidental and consequent to a particular loan (particularly when made on formal application therefor and subject to prior appraisal of land values and other conditions set forth in the Federal Farm Loan Act) a Joint Stock Land Bank

does not "*purchase*" the first mortgage, *i. e.*, either the mortgage note or mortgage. On the contrary, it is merely acquiring the mortgage note as evidence of the loan and acquiring the mortgage as security for the payment of the note.

Parenthetically, it would seem that the exception clause would involve only the *interest-bearing mortgage note* and not the *non-interest-bearing mortgage*, inasmuch as the exception clause covers only indebtedness "to purchase or carry" "obligations or securities the *interest* upon which is wholly exempt from taxation under this title". This distinction, however, does not control the determination of the issues. It has, nevertheless, a bearing on the argument *infra* and suggests that the unit term "first mortgage" (including both the mortgage note and the mortgage) should be visualized, in contemplation of the exception clause and exemption section (as distinguished from the Federal Farm Loan Act), as projecting the mortgage note rather than the mortgage.

Conversely, the giving of such first mortgage as evidence of and security for the payment of the loan is not, in ordinary usage or in fact, a *sale* by the farmer of his first mortgage. In the Federal Farm Loan Act the farmer is referred to as a "borrower" (Sec. 10); "borrowers on farm land mortgages" (Sec. 8); "applicant for a loan" (Sec. 12 Eighth); "every borrower who shall be granted a loan" (Sec. 12 Tenth); and "mortgagor" (Sec. 15). *Nowhere in the Act is there any suggestion that the farmer is a vendor or in any manner involved in the transaction of a purchase and sale.* Incidentally, the Court of Claims refers to the farmers as "borrowing landowners" (R. 24) and "borrowing farmers" (R. 25).

As we have seen, the purpose of the creation of Joint

Stock Land Banks, as expressly stated in the Federal Farm Loan Act (Sec. 16), was "for carrying on the business of *lending* on farm mortgage security and issuing farm loan bonds". The Joint Congressional Committee, *supra*, p. 31, states "Joint-stock land banks are not permitted to engage in any business but *making farm mortgage loans* and issuing bonds". In the Farm Loan Act all the language of Sec. 16, in respect of a Joint Stock Land Bank, proclaims its operations to be that of loaning and, moreover, refers to "mortgages *taken* by it in accordance with the terms of this Act". The word "taken" is quite an apt word, inasmuch as *all that any lender does is to "take" the borrower's note and security,—he does not "purchase" them.* To this effect also are the words "to receive" in Sec. 13 Third. Incidentally, the Court of Claims (R. 23) adopts the word "acquired" in respect of the transaction.

Some reference, however, should be made to the word "purchase" as used in Sec. 13 (Second) of the Federal Farm Loan Act which has to do specifically with the powers of Federal land banks (as distinguished from Joint Stock Land Banks), viz.: "to invest such funds as may be in its possession in the *purchase* of qualified first mortgages on farm lands situated within the Federal Land Bank district within which it is organized or for which it is acting". This particular language of purchase may have been intended by Congress as an additional power, distinct from the loaning power of a Federal land bank, *i. e.*, to purchase existing qualified first mortgages originated otherwise than through the corporate agencies, to wit, National Farm Loan Associations (Sec. 7, 8, 9, 10 and 11) and other corporate agencies (Sec. 15) through which Federal land bank loans (as distinguished from Joint Stock Land Bank loans) must be made. The acquisition of an existing mortgage from the

original lender or a subsequent holder in title is, in common usage, deemed a purchase, so the use of the word "purchase" in expressing such a power would be quite consistent with common usage. To the extent that Sec. 13 (Second) may have any application as descriptive of the *lending operations* of a *Federal land bank*, the word "purchase" would find justification in the fact that the National Farm Loan Associations and other corporate agencies (through which the loans of Federal land banks must be made) must endorse the farmer's mortgage and become liable for the payment thereof (Sec. 11 and Sec. 15). The use of the word "purchase" in respect of the acquisition of the farmer's mortgage from or through an intermediate obligor would be quite consistent with common usage. This is supported by the language in the only other section where language of purchase and sale is used, to wit, a paragraph in Sec. 15, which reads:

> "Any agent negotiating any such loan (for a Federal land bank) shall endorse the same and become liable for the payment thereof, and for any default by the mortgagor, on the same terms and under the same penalties as if the loan had been originally *made* by said agent *as principal* and *sold* by said agent to said land bank."

Incidentally, in this provision Congress again follows common usage in its distinction between the original acquisition of a mortgage note and mortgage in connection with a loan (being the making of a loan) and the acquisition of them in a transaction subsequent to the original loan transaction (such subsequent transaction being a purchase,—the disposal being a sale).

Final and clear evidence of the Congressional differentiation between a "loan on first mortgage" and a "purchase" is found in Sec. 22 of the Federal Farm Loan Act, which provides that "amortization and other

payments on the principal of first mortgages" shall be "applied or employed as follows":

"In the case of a Federal land bank—

(a) To pay off farm loan bonds issued by said bank as they mature.

(b) To *purchase* at or below par farm loan bonds issued by said bank or by any other Federal land bank.

(c) To *loan on first mortgages* on farm lands within the land bank district, qualified under this Act as collateral security for an issue of farm loan bonds.

(d) To *purchase* United States Government bonds.

In the case of a joint stock land bank—

(a) To pay off farm loan bonds issued by said bank as they may mature.

(b) To *purchase* at or below par farm loan bonds.

(c) To *loan on first mortgages* qualified under section sixteen of this Act.

(d) To *purchase* United States Government bonds."

It is submitted that a Joint Stock Land Bank's acquisition of a farmer's first mortgage, in connection with a simple direct loan to a farmer on his sole responsibility as to payment, is not and does not involve a "purchase" of the first mortgage. Both common usage and the language of the Federal Farm Loan Act, consistent with common usage, preclude application of the word "purchase" in any ordinary sense to such an acquisition,—and the word "purchase" was used in its ordinary sense in the interest deduction exception clause.

Failing a purchase, it follows that such indebtedness of a Joint Stock Land Bank is not incurred or continued "to purchase". Nor is it incurred or continued "to carry", inasmuch as the act denoted by carry is predicated on, presupposes and can be manifested only in connection with a purchase and, consequently, such in-

debtedness is not incurred or continued "to purchase or carry".

One final word as to "carry",—disregarding for the sake of the argument the clear dependence of "carry" on "purchase" with both revolving around a purchase, let us deprive "carry" of its meaning of "to bear the burden of acquisition *by purchase*" and substitute the meaning of "to bear the burden of holding after acquisition" or "to support after acquisition". Plaintiff, incidentally, confesses that it cannot conceive what such a burden would be in contemplation of the exception clause, but submits that it must be some burden accruing after acquisition because "carry" denotes possession. These latter meanings, it is submitted, represent the limit of any reasonable extension of the meaning of the word "carry". In the latter meanings, let us apply "carry" to the first mortgages acquired by a Joint Stock Land Bank as an incident to its loans.

Two classes of first mortgages are involved,—those already acquired in connection with past loans to farmers, and those to be acquired in connection with future loans to farmers. As to those already acquired, the farmer has received his full consideration and the Joint Stock Land Bank holds such first mortgages free, clear and unpledged. The Joint Stock Land Bank is under no necessity to do anything with these free, clear and unpledged first mortgages held by it. It can stop the process of flow and reflow of making loans and issuing bonds and retain these free first mortgages evidencing loans made with former borrowings. The bank is clearly under no necessity to borrow money to "bear the burden of holding" or "to support" them. It may, if it pleases, renew the process and use these free first mortgages as collateral security to borrow more funds to loan to farmers and acquire additional first mortgages, as contem-

plated in the Federal Farm Loan Act. One must ignore facts to say that such new borrowing is incurred or continued to "carry" these free first mortgages (used as collateral for the new borrowing),—inasmuch as they are free and clear in the hands of the Joint Stock Land Bank at the time of the borrowing and require no carry,—the farmer having received full consideration therefor.

As to the first mortgages to be acquired in the future, they likewise, since the farmers, respectively, have received full consideration at the time of acquisition through the loaning operation, are free and clear in the hands of the bank and require no "carry". Indebtedness incurred in expectation of making new loans and acquiring additional first mortgages is incurred to make the loans and not to "carry" the first mortgages subsequently to be acquired. In fact, a "carry" presupposes the existence and possession of the thing carried (be it a purchase or a security) and at the very moment the new first mortgages come into existence and into the possession of the Joint Stock Land Bank they are free and clear, so, obviously, the indebtedness incurred prior to such acquisition cannot be indebtedness incurred or continued "to carry" the future first mortgage because no "carry" eventuates.

To reduce this question to a simple equation, plaintiff submits that, so far as "purchase or carry" is concerned, a Joint Stock Land Bank's loaning to a farmer on his mortgage security and an ordinary bank's loaning to a customer on similar security are, in essence, the same. The note of the borrower is acquired by each as evidence of the loan and as security for the repayment of the loan each acquires a mortgage. Neither transaction, however, can be properly identified, in contemplation of the interest deduction exception clause, as being "to purchase or carry" the note or mortgage. The fact that the interest

on one note is exempt in respect of income tax and the interest on the other is not so exempt does not change the nature of either transaction.

To recapitulate briefly,—such indebtedness of a Joint Stock Land Bank is not within the literal meaning of "indebtedness incurred or continued to purchase or carry" in the interest deduction exception clause, in that, (a) the purpose of the indebtedness, in fact and as expressed by Congress, is simply to make loans to farmers, (b) the incidental acquisition of the farmers' first mortgages does not change such purpose or transmute it into that of "to purchase or carry" the farmers' first mortgages, and (c), even if the purpose of the indebtedness can be said to be to acquire the farmers' first mortgages, such acquisition does not involve a "purchase or carry". As to both purpose and use of the proceeds thereof, therefore, such indebtedness is not "incurred or continued to purchase or carry" farmers' first mortgages or, in fact, anything whatsoever. Therefore, at the threshold, it appears that such indebtedness of a Joint Stock Land Bank is not of the type designated in the interest deduction exception clause and the interest thereon is, therefore, deductible.

2.

THE FARMERS' FIRST MORTGAGES, IN ANY EVENT, ARE NOT "OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE", TO WIT, TITLE II OF THE REVENUE ACT OF 1921, IN THAT—

(a)

THE INTEREST ON THE FARMERS' FIRST MORTGAGES IS NOT EXEMPT UNDER TITLE II OF THE REVENUE ACT OF 1921, IN THAT THE FIRST MORTGAGES DO NOT FALL WITHIN SEC. 213 (b) (4) (b) THEREOF AS "SECURITIES ISSUED UNDER THE PROVISIONS OF THE FEDERAL FARM LOAN ACT".

The defendant initially contends that the farmer's first mortgage on his farm, given as evidence of and security for the payment of the loan to him, falls within the scope of Sec. 213 (b) (4) (b), viz.: "securities issued under the provisions of the Federal Farm Loan Act", that consequently the interest on such mortgages is "exempt from taxation under this title", viz.: the Income Tax Law of 1921, and that, therefore, the farmers' first mortgages are "obligations or securities the interest upon which is wholly exempt from taxation under this title",— as specified in the exception clause.

The plaintiff submits that the phrase "securities issued under the provisions of the Federal Farm Loan Act" was intended to and in fact comprises only securities issued by Federal Land Banks and Joint Stock Land Banks and possibly National Farm Loan Associations and does not include the farmer's first mortgages. The soundness of this construction of this phrase will be apparent, it is submitted, from a brief consideration of (1) contemporaneous Congressional language, (2) the legislative history of the phrase, (3) the non-exemption in fact of the farmers' first mortgages under the Income

Tax laws, (4) rulings of the Internal Revenue Bureau, and (5) the exact language of the phrase.

(1)

Contemporaneous language of Congress is obviously good evidence as to the Congressional intent and meaning of the words. In other words, what are the "provisions of the Federal Farm Loan Act" in respect of the "issue" of "securities"? The Federal Farm Loan Act was finally passed and became law in July, 1916. In Section 26 of that Act the Congress said:

> "*First mortgages executed to* Federal land banks, or to joint stock land banks, and *farm loan bonds issued under the provisions of this Act* (Federal Farm Loan Act) shall be deemed" and so forth.

This language clearly negatives any intent of the Congress to attach to farmers' "first mortgages *executed to joint stock land banks*" the character of being "issued under the provisions of" the Farm Loan Act, and, conversely, expressly segregates and designates the bonds of Federal Land Banks and Joint Stock Land Banks as being "issued under the provisions of" the Farm Loan Act. Even the punctuation confirms this intent.

Furthermore, in the Federal Farm Loan Act the word "issue" is consistently and repeatedly linked with "bonds" and there is not an instance where the word "issue" is linked with "farmers' first mortgages", but, on the contrary, "first mortgages" are repeatedly designated as "qualified" (Sec. 13 (Second), 18, 19 and 22) or "*made*" (Sec. 19). In Sec. 18 of the Act it is provided that if a Joint Stock Land Bank shall vote "to *issue* farm loan bonds under this Act" it shall tender to the Farm Registrar as collateral security "first mortgages on farm lands *qualified under the provisions of* Sec. 12, etc. of this Act". Likewise another section

(Sec. 19) repeats the distinction in the two phrases "any *issue* of farm loan bonds *under the provisions of* Sec. 18" and "mortgages *qualified under Sec. 12, etc. of this Act*". Likewise the quotation from Sec. 22 of the Federal Farm Loan Act (*supra*, p. 48) refers in sub-heading (a) to "*farm loan bonds issued* by said bank" and, in sub-heading (c) to "*first mortgages qualified* under section sixteen of this Act".

Immediately following the passage of the Farm Loan Act, the Congress in formulating the Income Tax Law of 1916, added to the interest exemption Section 213—

> "securities issued under the provisions of the Federal Farm Loan Act".

The almost contemporaneous origin and adoption of "securities issued under the provisions of the Federal Farm Loan Act" confirms this phrase as being in the Congressional mind the equivalent of "farm loan bonds (*i. e.* bonds issued by Federal Land Banks and Joint Stock Land Banks, respectively) issued under the provisions of this Act", plus possibly additional securities (*infra*, p. 58),—excluding, however, the farmers' first mortgages.

Plaintiff submits that the above references to the Federal Farm Loan Act offer a clear manifestation of the Congressional intent as to the meaning of "securities issued under the provisions of the Federal Farm Loan Act" considered as a unit. Treating the phrase as a group of isolated words (attributing unrelated meaning and significance to each) not only makes more difficult any identification of the securities intended but also entails considerable discussion to show that the words, even if considered independently, do not fit together and into the Congressional intent and history unless they are given the meaning and significance which the context of the whole phrase would originally attribute to them.

(2)

The intent of this apparently clear language is confirmed by reference to the legislative history of the phrase "securities issued under the provisions of the Federal Farm Loan Act" as it appears in Section 213.

The Revenue Act of 1916 was introduced into the House of Representatives on July 5, 1916, almost two weeks prior to the effective date of the Farm Loan Act, to wit, July 17, 1916. This Revenue Act as introduced (H. R. 16783) as originally reported in the House (64th Congress, 1st Session, House Reports, Vol. 3, No. 922) and as first reported in the Senate (Senate Documents, 64th Congress, 1st Session, Vol. 39, Document No. 531) was silent in respect of "securities issued under the provisions of the Federal Farm Loan Act". There was no change from the 1913 Act. As late as August 16, 1916, when the Finance Committee of the Senate reported the 1916 Revenue Act out (Senate Reports, 64th Congress, 1st Session, Vol. 3, No. 973) there was no reference to such interest exemption, although the Federal Farm Loan Act had been effective for a month. Later when the 1916 Revenue Act was being discussed in the Senate and after all formal amendments proposed by the Finance Committee had been exhausted, Mr. Simmons, as Chairman of the Committee, proposed from the floor the exemption which ultimately became Paragraph Fourteenth of Section 11. He also at the same time added to the interest exemption Section 4, *which dealt with exemptions to individuals*, the following:

> "or securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916".

In the Congressional Record, Vol. 53, part 13, at the end of page 13792, appears the following:

Mr. Simmons: Mr. President, on page 34 of the

bill, at the end of line 11, under the exemptions in reference to securities of farm and Federal Land banks, and so forth, I desire to offer a new paragraph in these words:

> Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank belonging to such joint-stock land bank.

That is an amendment suggested by the Secretary of the Treasury.

The President pro tempore: The Senator will send the amendment to the desk and it will be read.

The Secretary: On page 34, paragraph 'thirteenth' proposed by the committee, was passed over at the instance of the Senator from Utah. After that paragraph which has been passed over it is proposed to insert:

> Fourteenth. *Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank* belonging to such joint-stock land bank.

The President pro tempore: Unless there is objection, the amendment offered by the Senator from North Carolina on behalf of the Finance Committee will be agreed to. The Chair hears no objection, and it is so ordered.

Mr. Simmons: On page 8, line 10, after the word 'possessions', I move to add *'or securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916'.

The amendment was agreed to."

These two amendments were adopted in conference and as to the latter the conference report (House Reports 64th Congress, 1st Session, Vol. 3, No. 1200, dated September 7, 1916), reads merely:

> "This amendment exempts securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916, from the income tax provisions, and the House recedes."

These two last minute equivalent amendments were the twin children of the same thought, one referring to an exemption to Joint Stock Land Banks and the other

to individuals. The amendment paragraph Fourteenth refers to *"bonds or debentures of other Joint Stock Land banks or any Federal Land Bank"* and the exemption granted to individuals said the same thing in *"securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916". *When the Congress first used the language "securities issued under the provisions of the Federal Farm Loan Act" it was used in connection with exemptions to individuals.* Any attempt therefore, to enlarge the scope of "securities issued under the provisions of the Federal Farm Loan Act" beyond *farm loan bonds* issued by the Federal Land Banks and Joint Stock Land Banks (available in the open market), so as to include "farmers' first mortgages *executed to Joint Stock Land banks"* not only ignores the historical equivalence of the two amendments but also imputes to Congress an intent to grant an exemption to an individual in respect of a farmer's first mortgage which cannot be issued (if issued) to an individual and which, in addition, is not immediately available for purchase by an individual and which, until recently (*infra*, p. 61), was thought to lose its tax-exempt status in the hands of an individual.

The defendant inquires as to why Congress said "securities issued under the provisions of the Federal Farm Loan Act" rather than "bonds issued under the provisions of the Federal Farm Loan Act",—if it meant the bonds. In reply, it will be noticed that the paragraph Fourteenth, which was suggested by the Secretary of the Treasury, refers to "bonds or debentures of other Joint Stock Land Banks". This was error, inasmuch as Joint Stock Land Banks and Federal Land Banks did not issue debentures, but in a last minute amendment from the floor, possibly with some doubt in his mind, the one who formulated the phrase apparently cautiously

used a blanket expression—"securities issued under the provisions of the Federal Farm Loan Act". Under Sec. 11, Fourth, of the Federal Farm Loan Act National Farm Loan Associations have the power "to *issue* certificates against deposits of current funds bearing interest for not longer than one year not to exceed four per cent per annum after six days from date". It does not seem likely that such certificates of deposit could have been contemplated in the phrase "debentures of other Joint Stock Land Banks" as used by the Secretary of Treasury or his adviser. These certificates of deposit, however, are "issued under the Act" and, linked with the Farm Loan Bonds of Federal Land Banks and Joint Stock Land Banks, would justify the use of the word "securities" rather than the words "farm loan bonds" at the beginning of the phrase "securities issued under the provisions of the Federal Farm Loan Act". Incidentally, it might not be amiss to inquire of the defendant why Congress did not say "securities issued and first mortgages executed under the provisions of the Federal Farm Loan Act",—if it meant to include the first mortgages.

(3).

Further confirmation that farmers' "first mortgages executed to Joint Stock Land banks" are not "securities issued under the provisions of the Federal Farm Loan Act" in Section 213, is found in the fact that historically the interest on such first mortgages is not exempt under Section 213. It would be, of course, if such first mortgages were "securities issued under the provisions of the Federal Farm Loan Act". So far as anything in the Income Tax Law of 1916 is concerned, interest on the farmers' first mortgage notes was taxable income to Joint Stock Land Banks, inasmuch as paragraph Four

teenth exempts only "income from bonds or debentures of other Joint Stock Land banks or any Federal land bank". It is only the exemption granted in Section 26 of the Farm Loan Act which would prevent taxation under the 1916 law of the farmers' mortgage notes. So, directly contrary to the Government's contention, *interest* on the *first mortgages* rather than being exempt to Joint Stock Land Banks was taxable *under the* 1916 *Income Tax Law.* It remains, therefore, to see if there has been any subsequent change in the meaning of the phrase "securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916". Coming to the provisions of the Revenue Act of 1918 in these respects, we find that the Revenue Act of 1918 was set up under new titles and new sub-heads but the exemptions *as to individuals* contained in Section 4 of the 1916 Act were retained in Section 213 (b) (4) (b) of the 1918 Act, to the effect that interest upon the "securities issued under the provisions of the Federal Farm Loan Act" was exempt from taxation. This was the same exemption, no more no less, as that contained in Section 4 of the 1916 Act. The report of Ways and Means Committee of the House of Represetnatives (65th Congress, 2nd Session, H. R. Vol. 2, Report No. 676), in reporting the 1918 Revenue Act, states:

> "The bill (Section 212), defines net income to mean the gross income as defined in Section 213 less the deductions allowed by Section 214. Gross income will include the same items of income as are included under the present law,"

with exceptions not pertinent to this discussion. And again:

> "Section 214 of the bill allows the same deductions from gross income as under existing law,"

with exceptions not pertinent to this discussion.

By Section 233 of the Revenue Act of 1918, the gross income *of corporations* is made the same as the "gross

income as defined in Section 213" in respect of *individuals*,—with certain exceptions not pertinent to this discussion.

In this report of the Committee of Ways and Means, referring to Section 234 dealing with deductions allowed *corporations*, the Committee says:

> "* * * the bill * * * contains the *same limitations* in respect to the *tax free interest* received by the *corporation* which is applied in the case of an *individual*. The matter is discussed under the head '*deductions*' *under the portion of this report relating to the individual income tax.*"

From the above it is obvious that the 1918 Revenue Act exemption of income from "securities issued under the provisions of the Federal Farm Loan Act" was borrowed from the 1916 Revenue Act, and the words "securities issued under the provisions of the Federal Farm Loan Act" meant exactly what they meant in the 1916 Act.

The next step is to follow the clause "securities issued under the provisions of the Federal Farm Loan Act" into the 1921 Act and here again we find that it means exactly what it meant in the 1916 Act, no more no less. The Revenue Act of 1921 (H. R. 8245, 67th Congress, 1st Session, Vol. 8, Senate Document No. 73) when originally introduced, contained the same language as Section 213 (b) (4) (b) and Section 214 in respect of individual income taxability, and the same language as Section 233 and Section 234 of the 1918 Act in respect of corporate income taxability. Although there was considerable amendment in the Senate and the Bill was changed to a great extent, both as to form and as to substance, by the Senate, these Sections came through as set out in the original House Bill, and the reports in the Senate and in the House and the Conference reports,

so far as the writer has been able to discover, make no mention of these provisions.

(4).

The rulings of the Internal Revenue Bureau indicate quite clearly this limited scope of the phrase "securities issued under the provisions of the Federal Farm Loan Act". For instance, the Income Tax Unit in construing the Revenue Act of 1921 holds:

> "The net income of joint-stock land banks is subject to Federal income tax. If such a bank borrows money from other banks and gives its interest-bearing notes for the same, the interest paid by the joint-stock land bank to the holders of the notes is subject to Federal income tax to the same extent as interest derived from other promissory notes, as promissory notes of joint-stock land banks do not enjoy a tax-exempt status with reference to interest paid upon the loans they cover." (Internal Revenue Bureau Cum. Bull. II-29-1145; I. T. 1806 p. 92; Dec. 1923.)

The Unit quite correctly determines that a *note given by a Joint Stock Land Bank*, a Federal agency owing its existence to the Federal Farm Loan Act, does not "enjoy a tax-exempt status". It would, of course, if it were a security "issued under the provisions of the Federal Farm Loan Act". If the promissory note *of a Joint Stock Land Bank* does not fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act", clearly a *farmer's* mortgage note "executed to" a Joint Stock Land Bank does not fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act".

In I. T. 2470, Cum. Bull. VIII-17-4181, the Unit had occasion to determine the much debated question whether the interest on a farmer's first mortgage was exempt

from income tax in the hands of an individual to whom it had been sold by a Federal Land Bank. Obviously, if such first mortgage fell within the phrase "securities issued under the provisions of the Federal Farm Loan Act" in the interest exemption section the interest on such note would be exempt beyond question. The Unit, however, did not place its ruling upon any such basis but, on the contrary, quoted Sec. 26 of the Federal Farm Loan Act as follows:

> "First mortgages executed *to* Federal land banks * * * shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the *income* derived therefrom shall be exempt from Federal * * * taxation. (Italics supplied.)"

and held that the exemption granted in Sec. 26 to the farmer's mortgage note was a continuing exemption in the hands of an individual to whom it had been sold. The unit adopted, it is submitted, a very extended construction of Sec. 26 of the Federal Farm Loan Act when the same result could have been easily reached under the exemption section of the Income Tax Law, if it were a fact that the farmer's first mortgages fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act".

(5).

The exact language of the phrase "securities *issued* under the provisions of the Federal Farm Loan Act" confirms the limited and exact scope of this phrase. In the first place, as we have seen, the Congress in Sec. 26 of the Federal Farm Loan Act indicated its intent when it referred to the farmers' first mortgages as being "executed" and the farm loan bonds as being "issued". As the Joint Congressional Committee, in referring to

Joint Stock Land Banks, said in its report (*supra*, p. 30):

> *"they will be permitted to make loans, and to issue farm loan bonds under the supervision of the farm loan board."*

In the second place, assuming for the argument that the word "issue" is in any sense applicable to the isolated act of the farmer in giving his note and mortgage (see *infra*, p. 66), both the farmers' mortgage notes and mortgages are, in legal contemplation, *issued* under the provisions of the respective States of Illinois, Iowa, Texas and Oklahoma and are not *"issued* under the provisions of the *Federal Farm Loan Act"*.

As to the mortgage note, it derives its vitality and legal status from the local State law and not from the Federal law. To be sure the Federal Farm Loan Act prescribes certain requirements in respect of the rate of interest, maturities, etc. but such are merely limitations superimposed in respect of certain attributes of the note originating under the State laws. There would be no note or interest thereon or maturity thereof in the absence of the local law recognizing the legal status and effect of a promissory note and fixing its attributes.

As to the mortgage (standing alone),—it may be questioned whether the non-interest-bearing mortgage (regardless of whether it is "issued under the provisions of the Federal Farm Loan Act") is within the scope of the interest-bearing "obligations or securities" of the exemption section,—not being interest-bearing it cannot be in the class of "securities" the "interest upon" which is exempt. Nevertheless, to meet any suggestion that the mortgage note and mortgage are to be considered as a unit and that, therefore, the attributes of the mortgage reflect themselves in the mortgage note, let us inquire if the mortgage falls within the scope of "se-

curities issued under the provisions of the Federal Farm Loan Act".

A local State statutory form of mortgage is commonly used. It is true that they are made so as to conform with certain provisions of the Federal Farm Loan Act, as contended by the defendant, so that they will be "qualified" and available to the Joint Stock Land Banks as collateral security for the issue of bonds. Such, however, does not stamp them as within the phrase "issued under the provisions of the Federal Farm Loan Act" and no intent of Congress so to stamp them has been disclosed. Provisions under the Federal Farm Loan Act in respect of these mortgages are merely restrictions on the Joint Stock Land Bank. Absolutely valid first mortgage notes and mortgages conforming in all respects with the restrictions imposed by the Act may be created without reference to the Farm Loan Act and, on the other hand, a mortgage loan made by a Joint Stock Land Bank in good faith which may ultimately be unacceptable to the Registrar as a qualified "first mortgage" is nevertheless a valid subsisting mortgage,—clearly indicating that the mortgages (if issued) are "issued" under the State laws.

A farmer's mortgage does not trace its 'issuability' to the Federal Farm Loan Act but, on the contrary, derives its vitality and legal status and effect solely from the law of the State in which it is effective,—this applies even down to the incidences of the mortgage, such as the period of redemption allowed the mortgagor in the event of foreclosure.

It is true that Joint Stock Land Banks exist only by virtue of the Federal Farm Loan Act and farmers' mortgages are essential elements of the farm loan scheme, but such does not classify farmers' mortgages

as "issued under the provisions of the Federal Farm Loan Act". A mortgage received by an Illinois corporation, for instance, would not be "issued under the provisions of" the Illinois statute under which such corporation was created, but would be "issued under the provisions of" the conveyancing statutes of Illinois.

Furthermore, ordinary mortgage bonds, owing their origin to the laws of a particular State, contain provisions which will meet the requirements of the laws of other States so that they will be acceptable to purchasers in view of these statutory requirements, as to taxes for instance, but it does not follow that the bonds are "issued under the provisions of" the laws of these other States. Many real estate mortgages are deliberately set up in respect of the terms and margin of security and so forth, so they will be acceptable for trust fund investment in contemplation of various States' statutes regulating trustees in the investment of trust funds, and yet such mortgages are "issued under the provisions of" the local law and are in no way "issued" under the provisions of the various States' statutes regulating trustees in respect of investment of trust funds.

In conclusion, as we have seen, obligations the interest on which was originally exempted in the income tax law exemptions were obligations or securities of a State, Territory, or any political subdivision thereof, or the District of Columbia, or obligations of the United States or its possessions. These were Government obligations. To these subsequently were added bonds of War Finance Corporation,—a distinct Government agency, and "securities issued under the provisions of the Federal Farm Loan Act". It is submitted that the latter were intended to comprise only the securities issued by Governmental agencies, to wit, the Federal Land Banks and the Joint Stock Land Banks, and these securities are Federal Land

Bank Bonds, Joint Stock Land Bank Bonds, National Farm Loan Association Certificates of Deposit, and, since the amendment to the Federal Farm Loan Act approved March 4, 1923, Federal Intermediate Credit Bank Debentures. Incidentally, the word "securities issued under the provisions of the Federal Farm Loan Act" has expansive flexibility. The obligations and securities on which interest is exempt in Section 213 of the Income Tax Law are only ones of high rank and dignity, as established by their contextual relationship. *There is nothing which would delude a farmer's "first mortgage" into the belief that it could mingle in the society of such "obligations or securities".*

In the third place, it is doubtful if ordinary usage countenances the application of the word "issue" in any literal sense to the act involved in the inception and giving by a farmer of an individual mortgage on his farm in connection with a particular loan based on a particular appraisal of values, etc. We speak of corporate bond *issues*, but the borrower of money on the security of his farm or home, evidenced by a single mortgage instrument, "gives" or "makes" rather than "issues" his mortgage.

It is submitted, therefore, that (1) contemporaneous Congressional language, (2) the legislative history of the phrase, (3) the non-exemption in fact of farmers' first mortgages under the Income Tax Law of 1921, (4) the rulings of the Internal Revenue Bureau, and (5) the exact words of the phrase, manifest clearly that the farmers' "first mortgages *executed to* joint stock land banks" do not fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act" as used in Sec. 213 (b) (4) (b) of the Income Tax Law of 1921. If they do not fall within this particular phrase they admittedly do not fall within Sec. 213 (b) (4) and

are, therefore, not "obligations or securities the interest upon which is wholly exempt from taxation under this title", to wit, Title II of the Revenue Act of 1921, commonly referred to as the Income Tax Law of 1921.

Comment on Opinion Below.

May brief comment be made on the opinion below on this point, so as to avoid possible misunderstanding of the plaintiff's argument here and in the court below. Plaintiff's major contention below on this point was, as it is here, that the farmers' first mortgages are not within the scope of "securities issued under the provisions of the Federal Farm Loan Act",—designated in the *exemption section* (and consequently not within "obligations or securities the interest upon which is wholly exempt from taxation under this title",—designated in the exception clause). In addition, plaintiff contended below, as stated by the Court of Claims (R. 22, middle of page) that the farmers' first mortgages are not obligations or securities in contemplation of the *exception clause* in that the words "obligations or securities" as used in the exception clause (apart from refinements of the meaning of "exempt from taxation under this title") comprehend only a special class of obligations or securities (to wit, those similar in type to those mentioned in the exemption section) and not obligations and securities in general (*infra*, p. 74),—plaintiff conceding below, as it does here, that the farmers' first mortgages (more particularly the notes) are generally speaking obligations and securities and expressing no dissent from the definition of securities adopted by the Court of Claims (R. 23) as follows:

> "Securities (plural)—Is in use as a general form for written assurances for payment of money; evidences of debt."

The Court of Claims (possibly misled by the order or language of the plaintiff's brief into a misconception of the plaintiff's contentions) fails in its reasoning (R. 22-26) to consider either of the plaintiff's contentions. The Court, although it initially addresses itself (R. 22) to the second contention of the plaintiff, which is directed to the scope of the words "obligations or securities" in the *exception clause*, proceeds to demonstrate that the farmers' mortgage notes and mortgages are, generally speaking, obligations and securities and that, because the farmers' first mortgages can be and are used as "collateral security" under Sec. 18 of the Federal Farm Loan Act, they are securities in contemplation of the *Federal Farm Loan Act*, which, plaintiff submits, is irrelevant and in respect of which plaintiff made (and now makes) no contention,—notwithstanding that the Court (R. 24) attributed such a contention to the plaintiff.

The Court, without any consideration of the meaning of "securities issued under the provisions of the Federal Farm Loan Act",—in the *exemption section* and without further reference (other than to state the contention) to the scope of "obligations or securities" in the *exception clause*, concludes that the farmers' first mortgages are "*securities under* the provisions of *the Federal Farm Loan Act*" and that, consequently, the interest thereon is exempt from taxation under Sec. 213 (b) (4) of the Income Tax Law. Plaintiff submits that not only is it immaterial whether the farmers' first mortgages are "*securities under* the provisions of the Federal Farm Loan Act", *i. e.*, securities in contemplation of the Federal Farm Loan Act, but also that Sec. 213 (b) (4) of the Income Tax Law contains no exemption in respect of interest on "*securities under* the provisions of the Federal Farm Loan Act".

Coming to a consideration of what applciation the reasoning of the Court of Claims may have in the interpretation of "securities *issued* under the provisions of the Federal Farm Loan Act",—plaintiff concedes, as it did below, that the farmers' mortgage notes (and first mortgages as including mortgage notes) are securities in the sense of "written assurances for payment of money" which, it is submitted, is (with the added element that they bear interest) the sense of "securities" in subsection (b) of the exemption section, so it is not necessary to prove this fact. Such does not, however, make them "securities issued under the provisions of the Federal Farm Loan Act".

Parenthetically, plaintiff submits that the fact that the farmers' mortgages are "security" for the payment of the farmers' mortgage notes does not make them "securities" in contemplation of the exemption section and that "security", in the sense of meaning something given, deposited or pledged to secure the payment of a debt,—as set forth in the definitions adopted by the Court of Claims (R. 22, 23), does not reflect the meaning of "securities" in the exemption section. Such a meaning would exclude even *farm loan bonds* from the phrase "securities issued under the provisions of the Federal Farm Loan Act",—inasmuch as such bonds are not used, in contemplation of the Federal Farm Loan Act, to secure the payment of a debt, (*i. e.*, as security) but are, nevertheless, not only "securities" but concededly and obviously "securities issued under the provisions of the Federal Farm Loan Act". Incidentally, the farmer's first mortgage, even in the sense of "security", is not "issued" by the Joint Stock Land Bank (as are its bonds) but, on the contrary, is merely deposited by way of pledge as security for the issue of farm loan bonds or, as stated in Sec. 22 of the Federal Farm Loan Act,

"any first mortgage • • • *pledged* as collateral security for the *issue* of farm loan bonds".

Plaintiff submits that the fact that farmers' first mortgages (*i. e.*, both mortgage notes and mortgages) are referred to as "collateral security" in Sec. 18 of the Federal Farm Loan Act and under said Act may be and are used as collateral security against the issue of Joint Stock Land Bank Bonds, does not give the farmers' first mortgages the status of "securities issued under the provisions of the Federal Farm Loan Act". The very language of Sec. 18, referred to by the Court, disproves, it is submitted, any such conclusion. Sec. 18 provides that if a Joint Stock Land Bank votes *"to issue farm loan bonds under this act"* it shall make application and tender therewith to the farm loan registrar "as collateral security *first mortgages* on farm lands *qualified under the provisions* of section twelve, section fifteen, or section sixteen *of this Act*, or *United States Government bonds*, not less in aggregate amount than the sum of the *bonds* proposed to be *issued*".

In the first place, the bonds are *issued* and the first mortgages are *qualified* under the Act. Obviously, the phrase "securities issued under the provisions of the Federal Farm Loan Act" is not given its literal interpretation if the word "issued" is ignored (as it apparently was by the Court of Claims) or if there is substituted for the word "issued" any of the following words: "executed to", "qualified" and "taken",—which are the words used in the Federal Farm Loan Act as descriptive of the farmers' first mortgages.

In the second place, United States Government bonds may be used *pari passu* in lieu of farmers' first mortgages as "collateral security". If farmers' first mortgages by virtue of being used as "collateral security"

become "securities issued under the provisions of the Federal Farm Loan Act" then, by the same token, *United States Government bonds become "securities issued under the provisions of the Federal Farm Loan Act"*. The Court of Claims (R. 24), sensing this difficulty, interpolated the following:

> "While bonds of the Government of the United States are authorized to be tendered and used as collateral security for farm loan bonds, it is a matter of common knowledge that they are not so used by joint stock land banks for that purpose to any appreciable extent."

One final comment on the reasoning of the Court of Claims, the Court (R. 24, 25) refers to Sec. 26 of the Federal Farm Loan Act and Opinion of the Attorney General as supporting the point that "Congress intended to make the notes and first mortgages of borrowing landowners, securities, by the language used in Sec. 18 of the Federal Farm Loan Act" (R. 24, bottom). Plaintiff, repeating that the fact that the farmers' first mortgages are "securities" is conceded, submits that Sec. 26 of the Federal Farm Loan Act (see *supra* p. 53) and the Opinion of the Attorney General (see *supra* p. 33) distinctly indicate that the farmers' first mortgages are not within the scope of "securities issued under the provisions of the Federal Farm Loan Act".

Plaintiff submits, therefore, that the conclusion of the Court of Claims that the farmers' first mortgages are "securities under the provisions of the Federal Farm Loan Act" does not meet the points at issue and, further, that, although the Court of Claims in one place (R. 22) refers in passing to farmers' first mortgages as "executed and issued under the provisions of the Federal Farm Loan Act", the reasoning of the Court does not justify either a conclusion that the farmers' first mortgages are "securities issued under the provisions

of the Federal Farm Loan Act" (the major contention of the plaintiff on this point) or a conclusion that the farmers' first mortgages are "obligations or securities" in contemplation of the meaning of the interest deduction exception clause (the second contention of the plaintiff).

The balance of the opinion of the Court of Claims is addressed to other considerations, which will be referred to later (*infra* p. 80).

(b)

THE FARMERS' FIRST MORTGAGES DO NOT FALL WITHIN "OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE" AS A CONSEQUENCE OF ANY TAX EXEMPTION DERIVED EXCLUSIVELY FROM THE INCIDENTAL PROVISIONS OF THE FEDERAL FARM LOAN ACT.

The defendant contends, secondarily and in the alternative, that (even though the farmers' first mortgages do not fall within Sec. 213 (b) (4) of Title II of the Revenue Act of 1921 as "securities issued under the provisions of the Federal Farm Loan Act" and consequently are not obligations or securities the interest upon which is wholly exempt under this title) the farmers' first mortgages and the "income" thereon are exempt under Sec. 26 of the Federal Farm Loan Act and consequently (the interest on said first mortgages, as one phase of "income" thereon, being exempt from income tax) the first mortgages fall within "obligations or securities the interest upon which is wholly exempt from taxation under this title". In other words, plaintiff submits, the defendant urges an interpretation which, ignoring the historical and contextual relation between the interest deduction exception clause and the interest exemption section of the Income Tax Law (Sec. 213 (b) (4)), deprives

the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" of any significance as a descriptive unit in its entirety and, segregating and construing the words "exempt from taxation under this title" as the equivalent of exempt from the tax imposed by this title, applies such construction, without reference to any specific Congressional intent, to any and all obligations or securities, provided, of course, they are interest-bearing. Such an interpretation must, obviously, rest on more than mere assertion. The Court of Claims did not refer to this contention,—possibly deeming it unnecessary in view of its holding on the other point.

The plaintiff submits that the Congressional purpose in adopting the interest deduction exception clause (*supra* p. 14), the interrelation of the wording of the interest deduction exception clause and the exemption section of the Income Tax Law (*supra* p. 24), and the fact that Congress specified in the exemption section each and every interest-bearing obligation or security available in the open market for purchase by anyone seeking to get the double benefit of an *interest deduction* on indebtedness and an *interest exemption* on securities purchased, indicates clearly that the Congress meant by the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" only obligations or securities specified in the exemption section of the Income Tax Law (Sec. 213 (b) (4)). In other words, the "obligations or securities the interest upon which is wholly exempt from taxation under this title" are the obligations and securities listed in the interest exemption section and specified therein as "obligations" "or" "securities" "the interest upon" "which shall be exempt from taxation under this title."

Any contrary interpretation of the interest deduction exception clause, arrived at by breaking down the clause into three parts, to wit, "obligations or securities", "the interest upon which" and "is wholly exempt from taxation under this title", and attributing to each of such parts an unrelated significance, should, in view of the above evidence of Congressional intent, be rejected,—unless clear manifestation of Congressional intent in support thereof can be adduced.

As we have seen (*Appeal of Greenville, supra,* p. 22), "obligations or securities" in the exception clause are not tax-exempt obligations or securities in general, such as "stocks",—whether interest-bearing or dividend-bearing, and are clearly not securities of a non-interest-bearing character. The words "the interest upon which is wholly exempt from taxation under this title" must be treated as a unit describing the obligations or securities intended. The giving of an independent and unrelated status to the words "the *interest* upon which" entails the conclusion that the Congress, in drafting the exception clause, was *arbitrarily* penalizing the purchase of all obligations or securities which carry *interest,* as distinguished from obligations or securities which carry *dividends* or *rents, issues and profits.* Clearly this is not so, and the Congress, in drafting the interest deduction exception clause, was, obviously, denying the deduction of interest on indebtedness incurred to purchase not tax-exempt obligations or securities but definitely visualized "obligations or securities",—again not those which, by chance, bore interest (and were tax-exempt) but those "the *interest* upon which is wholly exempt from taxation under this title". All obligations and securities listed under the exemption in Sec. 213 (b) (4) of the Income Tax Law carry interest as distinguished from dividends or rents, issues and profits. These

"obligations" or "securities" listed in the exemption section (Sec. 213 (b) (4)), being exclusively interest-bearing obligations or securities, it was natural for the Congress, in phrasing the *exemption* section to provide that the *interest* on these obligations or securities shall be "exempt from taxation under this title" (see Appendix) rather than providing that, say, the "income" should be exempt. Furthermore, the "obligations" or "securities" listed in the exemption section being those which were available in large quantities in the open market for purchase with borrowed money and being, moreover, exclusively interest-bearing obligations or securities, the Congress, in phrasing the *interest deduction exception clause*, which was designed to "discourage this practice" of borrowing money to purchase such securities, automatically identified them as "obligations or securities the *interest* upon which is wholly exempt from taxation under this title",—in other words, the interest-bearing "obligations or securities" referred to in the interest exemption section (Sec. 213 (b) (4)). The alternative interpretation of the defendant also ignores the significance of the use of the words "exempt from taxation under this title" in both the exception clause and the exemption clause.

Congress, it is submitted, in the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title", used simple and direct phraseology to define the exemptions in mind,—those in the exemption section, and, therefore, there is no justification, in the absence of clear manifestation of Congressional intent to the contrary, for the seeking out of possible secondary meanings of the phrase,—even assuming such secondary meanings do not do violence to the exact language.

Finally, even aside from all the above considerations,

plaintiff submits that the defendant's proposed construction of "exempt from taxation under this title" does violence to the language itself. Space forbids elaborate itemization but a reading of the language of the Income Tax Law (see Appendix) indicates that the phrase "exempt from taxation under this title" was intended to designate exemptions under this title, and the words "from taxation" are adverbial (adhering to the verb "exempt"),—if, in fact, they are not fortuitous. In Sec. 1207 of the Revenue Act of 1917 (see Appendix) is found the progenitor of this phrase, in the following language:

> "except on indebtedness incurred for the purchase of obligations or securities the *interest upon which is exempt from taxation as income under this title.*"

Clearly, in this clause, which was the original exception clause, the phrase "from taxation" is either fortuitous or must be read as adhering to the verb "exempt" rather than adhering to "under this title". Again, in Sec. 213 of the 1918 Act (see Appendix) we find the phrase:

> "only if and to the extent it is *wholly exempt from taxation to the taxpayer* under this Title and under Title III."

Here again the phrase "from taxation" is obviously adverbial or fortuitous. Again in the deduction section of the 1918 Act (see Appendix) we find:

> "the interest upon which is wholly *exempt from taxation* under this title *as income to the taxpayer.*"

Here again "from taxation" is either adverbial or fortuitous. Certainly it could not mean "exempt from the *tax imposed by this title as income to the taxpayer*".

Further, plaintiff submits that the defendant, if it asks this Court to hold that the Congress intended "exempt from taxation under this title" to mean exempt

from the tax imposed by this title, should demonstrate to this Court wherein the Congress manifested such intent and also why the Congress did not express such an intent in simple language. We have seen that the Congress did not intend to deny deduction of interest on indebtedness incurred to purchase *tax-exempt securities*, so it is understandable why the Congress did not use the phrase "tax-exempt obligations or securities" in lieu of "obligations or securities the interest upon which is wholly exempt from taxation under this title". If, however, Congress had in mind the denial of interest deduction on money borrowed to purchase any and all *interest-bearing* obligations or securities, it might well have adopted the exact language proposed by the defendant as the equivalent of the language used, because the phrase "tax imposed by" is not foreign to the Income Tax Law. It is found in all Acts at least as far back as the 1916 Act. It appears in various forms, "tax imposed by Title II", "income tax imposed by subdivision", etc. In the 1921 Act (the one at issue) a rough calculation indicates that the phrase *"tax imposed by"* "this section", "this title", "this subdivision" or "this Act", etc., appears at least twelve times. In fact, in Sec. 234 (a) (2) itself, under which the exception clause falls (*supra* p. 6), Congress used the phrase "tax imposed by" and yet in the exception clause thereof used the phrase "wholly exempt from taxation under this title". If such were the intention of the Congress or the law it would have been quite simple and natural to say, in the interest deduction exception clause, obligations or securities the interest upon which is "wholly exempt from the tax imposed by this title".

In conclusion, Sec. 26 of the Federal Farm Loan Act grants to *first mortgages* and the *"income"* derived therefrom an exemption from Federal, State, Municipal

and local taxation. This is the broadest exemption known to the law and includes (excluding estate and inheritance taxes) exemption from all types of taxation. The interest on the farmers' first mortgages is one phase of the "income" derived therefrom and, as such, is exempt under this broad exemption granted solely to serve the purpose Congress had in mind in creating the farm loan system (*supra*, p. 31). The defendant, working backwards from its alternative interpretation of "exempt from taxation under this title", neglects to demonstrate what immediate or direct significance this incidental (though essential) exemption conferred on such interest by Sec. 26 of the Federal Farm Loan Act, had in the Congressional mind when it was framing the interest deduction exception clause for the purpose of denying interest deduction on indebtedness incurred to purchase "obligations or securities the *interest* upon which is wholly exempt from taxation under this title". In view of the fact that the farmers' first mortgages were not and are not for sale in the open market and, therefore, not currently the subject of purchase with borrowed money, it is quite inconceivable that the Congress, in framing the interest deduction exception clause for the purpose of defeating the practice of purchasing "obligations or securities the *interest* upon which is wholly exempt from taxation under this title" did or could (intelligently) contemplate or attach any significance to this exemption conferred on the first mortgage interest under the blanket "*income*" exemption of Sec. 26 of the Federal Farm Loan Act.

D.

ANY INTERPRETATION THAT SUCH INDEBTEDNESS OF A JOINT STOCK LAND BANK FALLS WITHIN THE EXCEPTION CLAUSE REQUIRES AN EXTENSION BY IMPLICATION OR ENLARGEMENT OF THE PROVISIONS OF THIS CLAUSE, WHICH IS CONTRARY TO RULES LAID DOWN BY THIS COURT FOR THE INTERPRETATION OF STATUTES LEVYING TAXES.

Plaintiff submits, without repetition of argument or reasons, that the interpretations urged by the defendant and also the interpretation adopted by the Court of Claims are incompatible with the rules laid down by this Court for the interpretation of statutes levying taxes.

In *Gould* v. *Gould*, 245 U. S. 151, (p. 153) is the oft-quoted and oft-followed statement:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen. *United States* v. *Wigglesworth*, 2 Story, 369; *American Net & Twine Co.* v. *Worthington*, 141 U. S. 468, 474; *Benzinger* v. *United States*, 192 U. S. 38, 55."

The defendant, proceeding on the *letter* of the exception clause and confining its argument thereto, projects interpretations (in the alternative in one aspect) which it submits are within the strict letter of the statutes at issue but which, plaintiff submits, are not true literal interpretations, even treating the statutes as isolated words, and are clearly not true literal interpretations in the light of the purpose and intended scope of the interest deduction exception clause, considered in conjunction with the exemption section of the Income Tax Law and the Federal Farm Loan Act. Plaintiff further con-

tends that in the light of the purpose and intended scope of the interest deduction exception clause, the interpretations urged by the defendant extend the scope of the exception clause and the exemption section by implication "beyond the clear import of the language used" and enlarge their scope so as to "embrace matters not specifically pointed out".

Comment on Opinion Below.

The Court of Claims, in reaching its interpretation, it is respectfully submitted, ignored not only the *purpose and intended scope* of the interest deduction exception clause and its relation to the other statutes involved but also the *letter* of the interest deduction exception clause, also of the interest exemption section and also of the Federal Farm Loan Act,—*apparently influenced by several considerations which neither the plaintiff nor the defendant urged and other considerations which neither party urged or deemed pertinent to the issue when the matter was originally presented to the Court of Claims,* but which, in view of the statements contained in the original opinion of the Court of Claims, came into the case at the time of the rehearing before the Court below. In view of the stress placed on these several considerations by the Court below in its second opinion, comment thereon, at the risk of prolonging the argument, seems to be required.

The latter portion of the opinion below (R. 26, middle, to 31, incl.) is all predicated on the premise that the exception clause comprehends indebtedness incurred to purchase or carry "*tax-exempt*" obligations or securities (R. 30-31) or (R. 31) "the farmers' *tax-exempt* notes and first mortgages" because they are "securities under the provisions of the farm loan act",—note again

the absence of the word "issued". The language of the exception clause *per se*, it is submitted, clearly precludes such a premise and, furthermore, the plaintiff does not understand that the defendant adopts any such premise.

Proceeding on this premise, the Court of Claims, quite properly, holds that it is not justified in rewriting the exception clause (R. 31) in order to take such Joint Stock Bank indebtedness out of its provisions and, further, that it finds no provisions in the Federal Farm Loan Act (R. 31) which would take such Joint Stock Land Bank indebtedness out of the provisions of the exception clause. The plaintiff did not below, and does not here, ask the Court to rewrite the exception clause and does not urge that there is any provision of the Federal Farm Loan Act which would take such Joint Stock Land Bank indebtedness out of the exception clause if, in fact, it is comprehended within it. The plaintiff did, however, urge below, and resubmits here, that such indebtedness of a Joint Stock Land Bank does not fall within either the intended scope or the true literal meaning of the exact language of the exception clause and that such conclusion is confirmed by consideration of the purpose of the exception clause (which was to discourage a practice of tax avoidance) and also by consideration of the purpose of the Federal Farm Loan Act. Plaintiff resubmits that these considerations manifest a clear Congressional intent, which is not only consistent with the language used in the exception clause and corroborative of the plaintiff's construction thereof but is also properly to be heeded in construing the exception clause.

Referring further to the opinion below, the Court of Claims (R. 26-29) recites the purpose of Joint Stock Land Banks, elaborates on the benefits conferred on them to indicate that Congress expected them to be profitable

institutions, and concludes that the granting of certain privileges and benefits to them is not a reason to give them further benefits under the exception clause. This is obviously true and the plaintiff seeks no such concession. By the same token, the plaintiff, calling attention to the counterbalancing restrictions placed on the earning powers of Joint Stock Land Banks and pointing out that all these benefits, privileges and restrictions of the Federal Farm Loan Act were adopted solely because they were essential features of the farm loan scheme and not as primary tax legislation, urges that the interpretation of the scope of any provision of the Income Tax Law should not be colored by the consequences of any tax provision contained in the Federal Farm Loan Act,—unless, of course, the Congress manifests in the Income Tax Law an intent to such effect.

These restrictions in the Federal Farm Loan Act on the earning power of Joint Stock Land Banks were essential to the farm loan scheme,—as was the complete tax exemption contained in Sec. 26 of the Act. In order to get the money to the farmer at a low interest rate Congress expressly in the Farm Loan Act exempted from income tax the interest received on the farmers' first mortgages,—the United States absorbing the income tax loss. It also exempted the interest received by individual purchasers or holders of Joint Stock Land Bank bonds, in order to make these bonds salable,—the United States again absorbing the income tax loss. These things were done primarily not to benefit the Joint Stock Land banks or to penalize existing agencies which had theretofore loaned money to farmers, but primarily and in fact solely because the purpose of Congress was to get money to the farmer at a low interest rate and on reasonable terms, and the scheme definitely required such concessions. Any benefits or detriments to others were

incidental to the main Congressional purpose. Again, obviously to clinch its main purpose and not leave the farmer subject to any potential cupidity on the part of the Joint Stock Land Banks, a limit of six per cent interest was placed on the farmers' first mortgages. There were two additional stipulations for the farmer's benefit, viz.: that the rate of interest charged the farmers should be limited to a figure not in excess of one per cent above the rate of interest on the Joint Stock Land Bank's last issue of bonds and that the Joint Stock Land Bank could not charge any commissions whatsoever. These drastic restrictions on the earning power of Joint Stock Land Banks were, it was thought, counterbalanced by the permission to issue bonds for fifteen times the capital of the bank, which ratio was deemed safe considering the collateral behind the bonds. By this last apparently generous provision and others hereinafter mentioned the Congress indicated its desire that the operations of Joint Stock Land Banks should be profitable. Whether the provisions set up by Congress did or did not, in fact, sufficiently provide for the relatively profitable employment of funds invested in the capital of Joint Stock Land Banks or whether Joint Stock Land Banks, "when properly managed and operated in the manner contemplated in the farm loan act can not be otherwise than highly profitable" (R. 28), is, it is submitted, immaterial in respect of the intent of Congress when it passed the law.

Viewed in the light of the Federal Farm Loan Act, therefore, there is nothing to justify an imputation that the Congress affirmatively conceived or desired additional restrictions on Joint Stock Land Banks or their earning power over and above those expressly fixed in the Federal Farm Loan Act. If anything, the intent of Congress would be to the contrary inasmuch as any

lessening of the net earning power (within the restricted limitations) of its own creatures (Joint Stock Land Banks) would, however remotely, militate *pro tanto* against the success of the land bank system and would, however remotely, defeat *pro tanto* the prospect of the farmers' receiving lower interest rates. The denial of the interest deduction, if it would lessen to any extent the net earning power of any Joint Stock Land Bank, would, therefore, not find support from any intent of Congress manifested in the Federal Farm Loan Act and, at least, such denial cannot be predicated on any intent, express or latent, manifested in the Federal Farm Loan Act.

We now come to a consideration of the fact that the interest on the farmers' first mortgages comprises the major income of a Joint Stock Land Bank and, inasmuch as this interest is exempt under Sec. 26 of the Federal Farm Loan Act, Joint Stock Land Banks, as stated by the Court of Claims (R. 19) "do not ordinarily have income subject to taxation", and a consideration of the bearing of this fact on the interpretation of the interest deduction exception clause.

The Court of Claims, in its original opinion, (without expressing any opinion on the true literal meaning of the exception clause, to which the arguments of the plaintiff and the defendant were directed) concluded that the denial of such interest deduction would adversely affect Joint Stock Land Banks and, considering this in connection with other reasons, held that the Congress did not intend that the exception clause should apply to such indebtedness of Joint Stock Land Banks. The defendant, thereupon, in the rehearing proceedings, directed the court's attention to the fact that *in the particular case* the two subsidiary Joint Stock Land Banks had no independent net taxable income in 1922, aside from

any deduction of interest paid on their bonds, and pointed out that the deduction, if allowed, would redound solely to the benefit of the plaintiff as the parent company. The Court of Claims, granting the rehearing and reversing its judgment, held (again, it is submitted, without due regard to the letter of the statutory language and the Congressional intent) that such indebtedness of a Joint Stock Land Bank falls within the letter of the exception clause and such interest on the bonds was, therefore, not deductible. It is not apparent that the Court of Claims made these considerations the *ratio decidendi* of its opinion. In any event it did not expressly indicate the application of these considerations to the questions at issue. The Court, however, at the threshold of its opinion, conceding that the plaintiff would be entitled to the deduction in its consolidated return "if the Joint Stock Land Banks with which it was affiliated would have had a right to the deduction had they filed independent returns" (R. 19), emphasizes that the question arises solely because of the affiliation (true in the particular case) and that the deduction "in no way affects the Joint Stock Land Banks included in said consolidated return" (true, strictly income-tax-wise, in the particular and possibly also in the ordinary case) and, further, that "Joint Stock Land Banks have no taxable income and they pay no taxes".

As to this latter statement, in a broad sense it is true that Joint Stock Land Banks are not permitted "to engage in any business except that of *making loans to farmers and issuing their bonds* to secure the necessary funds therefor" (R. 19). On the other hand, the interest on farmers' mortgages, although a major source, is not the sole source of income of Joint Stock Land Banks. Other sources of taxable income (excluding items of

lesser importance such as loan fees and penalties on delinquent loans) are interest on bank deposits, profit on real estate, premiums on bonds sold and profit on outstanding bonds purchased at a discount. By Section 16 and Sections 13 Fourth (a) (b) and 13 Fifth of the Federal Farm Loan Act (39 Stat. 372), Joint Stock Land Banks are given the general powers of acquiring and disposing of such property, real or personal, as may be necessary or convenient to the transaction of their business, *which, however, may be in part leased to others for revenue purposes;* of acquiring parcels of land in satisfaction of debts or under foreclosure decrees and *of holding such land five years;* and of depositing securities and current funds with member banks of the Federal Reserve System and *to receive interest on the same as may be agreed.* These sources, including the sale of land acquired in foreclosure, are potentially productive of an appreciable income,—the taxable "net" of which would be increased *pro tanto* by the denial of the deduction of interest paid on Joint Stock Land Banks' bonds. Incidentally, it is conceivable that the operations of some Joint Stock Land Banks, in view of the present disturbed conditions under which they now operate (to be sure, not those immediately contemplated by Congress), might produce an appreciable independent net taxable income,—the interest deduction being denied.

In regard to the benefit of the deduction accruing to the plaintiff under its consolidated return, obviously the Income Tax Law provisions in respect of consolidated returns are a separate and distinct feature of the Income Tax Law adopted for a specific purpose. In the first place, as we shall see later (*infra*, p. 92), the Congress realized that such provisions might result in the collection in one case of higher taxes and in another case

of lower taxes. In the second place, the consequences of the consolidation of income of such affiliated companies under the consolidated return provisions, whether favorable to the Government and unfavorable to the taxpayer in the particular case, (or vice versa, they work both ways), have no pertinent or material bearing on the proper construction of other provisions of the Income Tax Law, such as the interest deduction question at issue, on which the net profit or loss of each company is initially determined. Obviously, Income Tax Law provisions must be construed independently of the consolidated return provisions and their interpretation should not be distorted by a consideration of the consequences of any such interpretation in view of consolidated returns. Any other course, it is submitted, would lead to chaos in respect of the interpretation of the respective provisions of the Income Tax Law. *In other words, the interest deduction clause should be construed in this case as though the Joint Stock Land Banks were independent companies and not involved in a consolidated return.* The Court of Claims agreed that the plaintiff would be entitled to the deduction in its consolidated return "if the Joint Stock Land Banks with which it was affiliated would have had the right to the deduction had they filed independent returns" (R. 19).

We come logically to an inquiry regarding what evidence of Congressional intent (in respect of the meaning of the interest deduction exception clause) can be found in the fact that Joint Stock Land Banks (filing independent returns, respectively) would ordinarily have no net taxable income,—irrespective of the interest deduction. Parenthetically, the fact that such Joint Stock Land Banks (filing independent returns, respectively) would *never* have any net net taxable income (irrespective of the interest deduction) obviously cannot have

any logical bearing on the Congressional intent in respect of the language of the interest deduction exception clause or the scope thereof, inasmuch as any hypothesis that the Congress did consider this fact in selecting the language and fixing the scope of the exception clause (with an intent to include the farmers' first mortgages so as to defeat a deduction of interest on such indebtedness of Joint Stock Land Banks, respectively) requires the inference that Congress added a futile provision, designed to bear on a situation which never would arise and to which it never could have any application. To return to the inquiry, and approaching the Congressional intent on the assumption that the Congress conceived that a Joint Stock Land Bank or some Joint Stock Land Banks, although not ordinarily, *might* have independent net taxable income (irrespective of the interest deduction), we find less justification for any interpretation of the interest deduction exception clause which would extend it by implication so as to include such indebtedness of Joint Stock Land Banks with the resultant denial of ordinary business interest deduction. In fact, considering that such indebtedness of a Joint Stock Land Bank is incurred to carry out the very purpose Congress specified in the Federal Farm Loan Act and was not incurred in any thought of tax avoidance, all implications would tend away from an enlargement of the scope of the clause by implication and toward, if not a restrictive interpretation, at least the true literal interpretation in the light of the precise language used and purpose of the clause,—free from any hypothetical inferences. The Court of Claims, in its first opinion (even without any reference to the precise language of the exception clause) held:

> "It is obvious that the purpose of Congress was to forestall a scheme devised by a taxpayer to re-

duce his taxes. But we cannot believe that Congress intended that the provisions of that statute should apply to the transactions involved in the operation of a Joint Stock Land Bank."

It is apparent, therefore, plaintiff submits, that the fact that a Joint Stock Land Bank ordinarily does not have (or even never may have) any independent net taxable income is immaterial in respect of the interpretation of the interest deduction exception clause and that a true focus brings us ultimately to a consideration of the fact that a parent company might, and in the particular case would, enjoy the benefit of the interest deduction if allowed. This incidental benefit accruing under the independent consolidated return provisions to a parent company, plaintiff repeats (*supra*, p. 86), can have no logical bearing on the interpretation of the interest deduction exception clause,—in the absence of a manifestation of Congressional intent in such respect.

So far as the writer has been able to discover from Committee hearings, Committee Reports and legislative debates in respect of the Federal Farm Loan Act and the interest deduction and consolidated return provisions of the Income Tax Law, there is no direct evidence that Congress was influenced by the fact that such interest deductions might redound to the benefit of a parent company. Of course, if Congress failed to consider this fact, it must follow (however much such failure might be deplored) that such fact had no bearing in the Congressional mind on the meaning of the interest deduction exception clause, the language thereof or the intent of Congress in respect thereof. If the defendant now urges that this fact has any bearing on the interpretation of the exception clause, it should indicate, it is submitted, wherein it is manifested or reflected in any Congressional act or in the language of the exception clause.

Incidentally, such would seem to be consistent not only with the rule of interpretation laid down in *Gould* v. *Gould* (*supra*, p. 79), but also with the rule laid down in *Ryan* v. *Carter* (93 U. S. 78, at p. 83), to the effect that:

> "The general rule of law is, that a proviso carves special exceptions only out of the body of the act, and those who set up any such exception must establish it as being within the *words* as well as the *reason* thereof."

Plaintiff submits that, failing direct evidence that the Congressional mind was influenced by this incidental benefit to a parent company under the independent consolidated return provisions, the interest deduction exception clause should, apart from any such consideration, be construed on the precise language thereof interpreted in the light of its purpose and the purpose of the Federal Farm Loan Act,—which would reflect the immediate and primary intent of Congress.

If the interpretation, thus arrived at, is to the effect that such indebtedness of a Joint Stock Land Bank is not "incurred or continued to purchase or carry obligations or securities the interest upon which is wholly exempt from taxation under this title", the fact that the parent company might in a particular case or in the majority of cases (or in any possible case, if the Court please) be the only one to benefit by the deduction, would not require rejection of such interpretation. In other words, this incidental benefit to a parent company under the consolidated return provisions is not so inconsistent with the Congressional intent manifested in respect of consolidated returns and interest deduction that it would control the interpretation of the interest deduction exception clause.

The plaintiff, submitting that it devolves on the de-

fendant to show such inconsistency (if any), urges that, on the contrary, such incidental benefit to a parent company is quite consistent with Congressional intent as disclosed in the Federal Farm Loan Act and the Income Tax Law.

In the first place, it is not unreasonable to assume that the Congress was aware that the interest on the farmers' first mortgages was a main source of Joint Stock Land Bank income and that such income was exempt under Sec. 26 of the Federal Farm Loan Act. Likewise that Congress was aware that institutions engaged in the farm loan business would not be able to carry on their operations in competition with the Joint Stock Land Banks and that it was not unlikely that banks or companies engaged, either directly or indirectly through subsidiaries, in the making of farm loans would convert these departments or subsidiaries into Joint Stock Land Banks. This, off the record, is what happened with the farm loan department of the plaintiff's subsidiary and, incidentally, was consistent with a suggestion of the Federal Farm Loan Bureau, which desired to have experienced farm loan bankers engage in Joint Stock Land Bank operations,—backed by the strong support of large and experienced financial institutions.

In the second place, the incidental benefit to a parent company is and was quite consistent with the purpose of consolidated returns. The Congress adopted the consolidated return in 1917, has followed it since, and in confirming that policy in connection with the Internal Revenue Bill of 1928 (Senate Committee on Finance, Senate Report No 960, 70th Congress, 1st Session), states the purpose in the following language (italics ours throughout):

> "The situation was described accurately and succinctly by Senator Simmons, at that time the Chair-

man of the Finance Committee and now its ranking minority member, in his report upon the 1918 revenue bill as follows:

> 'Provision has been made in section 240 for a consolidated return, in the case of affiliated corporations, for purposes both of income and profits taxes. A year's trial of the consolidated return under the existing law demonstrated the advisability of conferring upon the commissioner *explicit authority to require such returns.*
>
> So far as its immediate effect is concerned, *consolidation increases the tax in some cases and reduces it in other cases, but its general and permanent effect is to prevent evasion, which can not be successfully blocked in any other way.* * * *
>
> Moreover, a law which contains no requirement for consolidation puts an almost irresistible premium on a segregation or a separate incorporation of activities which would normally be carried as branches of one concern. Increasing evidence has come to light demonstrating that the possibilities of evading taxation in these and allied ways are becoming familiar to the taxpayers of the country. While the committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, *the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because the principle of taxing as a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government.'* ''

Finally, one more evidence of Congressional intent,—in Sec. 26 of the Federal Farm Loan Act the Congress conferred on every "Federal land bank and every national farm loan association" a tax-exempt status (income-tax-wise), which tax-exempt status was carried into the 1916 Income Tax Law (the year of the adoption of the Federal Farm Loan Act) under Sec. 11 (a) Thir-

teenth, which gave such Federal Land Banks and National Farm Loan Associations the status of tax-exempt corporations. *The Congress, however, did not, either in the Federal Farm Loan Act or the Income Tax Law of* 1916, *confer such tax-exempt status on Joint Stock Land Banks.* Sec. 26 of the Federal Farm Loan Act has remained unchanged and the Income Tax Laws of 1917 (Sec. 11 (a) Thirteenth), of 1918 (Sec. 231, (13)), and of 1921 (Sec. 231 (13)) retain the tax-exempt status in respect of "Federal land banks and national farm loan associations, as provided in Sec. 26 of" the Federal Farm Loan Act. *The Joint Stock Land Banks remain, as before, without any such exemption.* The Act of March 4, 1923 (42 Stat. 1459), which by way of amendment and enlargement of the scope of the Federal Farm Loan Act created the Federal Intermediate Credit Banks, conferred on these banks the tax-exempt status enjoyed by the Federal Land Banks and National Farm Loan Associations under Sec. 26 of the Federal Farm Loan Act. This tax exemption was immediately reflected in the 1924 Income Tax Law (Sec. 231 (13)), which conferred "on *Federal land banks, national farm loan associations, and Federal intermediate credit banks, as provided in the Federal farm loan act, as amended*", the status of tax-exempt corporations. This exemption is carried into the subsequent Income Tax Laws of 1926 and 1928. *The Joint Stock Land Banks have, as from the beginning, remained taxable corporations.*

This deliberate refusal to confer on Joint Stock Land Banks the status of tax-exempt corporations has, or at least is not inconsistent with, two clear inferences. First, the Congress contemplated that Joint Stock Land Banks might (or, at least, that *some of them* would) have net taxable income, and secondly, that Congress in-

tended that Joint Stock Land Banks should remain subject to the full incidences of the Income Tax Laws, including the consolidated return provisions, and that such Income Tax Laws should be applied to such Joint Stock Land Banks as they would be applied to other corporations, without favor or penalty,—the income tax provisions in the Federal Farm Loan Act being considered as special provisions adopted as essential to the particular purpose contemplated in the Federal Farm Loan Act. *On such considerations, undoubtedly, the Bureau of Internal Revenue predicated its holding* (*supra*, p 61) *that "the income of joint-stock land banks is subject to Federal income tax"*. In the last analysis, the fact remains that Congress deliberately left Joint Stock Land Banks subject to the Federal Income Tax Laws and did not exclude Joint Stock Land Banks from the operation of the consolidated return provisions or make any special rule that a minus net income of a Joint Stock Land Bank should be treated differently (in computing a consolidated net income reported by a parent company) from the minus net income of any other affiliated company.

In conclusion, plaintiff submits that the true literal meaning of the interest deduction exception clause should be sought in its precise language interpreted in the light of its purpose and, insofar as the the indebtedness of a Joint Stock Land Bank incurred to make farm mortgage loans is concerned, in the light of the purpose of the Federal Farm Loan Act and independently of any consideration of the benefit of the deduction accruing to a parent company; secondly, that the fact that a Joint Stock Land Bank may not or does not have any net taxable income and that the benefit of the deduction of interest on its bonds might or does accrue to a parent com-

pany under the consolidated return provisions of the Income Tax Laws has no logical bearing on the interpretation of the interest deduction exception clause; thirdly, that if implications are to be indulged in they should be based on some manifestation of Congressional intent and that Congress has not manifested any intent that this interest deduction should be denied because it might redound to the benefit of a parent company, or any intent which is inconsistent with the allowance of this interest deduction in the light of the interest deduction section of the Income Tax Law; and, finally, that the interest deduction exception clause should not be extended "by implication beyond the clear import of the language used" or enlarged "so as to embrace matters not specifically pointed out".

E.

IRRESPECTIVE OF THE INTENDED SCOPE OR LETTER OF THE INTEREST DEDUCTION EXCEPTION CLAUSE, ITS APPLICATION TO SUCH INDEBTEDNESS OF JOINT STOCK LAND BANKS MAY BE SERIOUSLY QUESTIONED IN VIEW OF A RECENT DECISION IN RESPECT OF THE CONSTITUTIONALITY OF THE EXCEPTON CLAUSE AND RULES OF CONSTRUCTION LAID DOWN BY THIS COURT.

Plaintiff, disclaiming any intention of making this point its major contention, submits, without elaboration of argument and more or less collaterally, the following considerations.

In the case of *Nauts* v. *Slayton,* 36 Fed. (2d) 145, (decided December 6, 1929, by the Circuit Court of Appeals, Sixth Circuit, and now pending before this Court on a Writ of Certiorari), it was held that the interest deduction exception clause, to the extent that it was applied to deny a deduction of interest on money borrowed to purchase or carry municipal bonds, was unconstitutional inasmuch as it in effect imposes a tax on municipal obligations,—such taxation not being within the power of Congress. In reaching this decision the Court relied on the case of *National Life Insurance Co.* v. *United States* (277 U. S. 508).

There is, of course, no constitutional limitation on the power of Congress, if it so desired, to deny deduction of interest on indebtedness incurred by a Joint Stock Land Bank to raise funds to loan to farmers under the Federal Farm Loan system. Let us assume for the sake of this argument that, as urged by the defendant, the exception clause contains such a denial. If the interest deduction exception clause is unconstitutional to the extent of its application to the denial of interest on money borrowed to purchase municipal bonds, the plaintiff submits that,

on the principles of construction laid down in *National Life Insurance Co.* v. *United States* (*supra*), at pp. 521-522, the interest deduction exception clause should not be applied so as to result in a denial of the deduction of interest on such indebtedness of a Joint Stock Land Bank, inasmuch as such application to such indebtedness would in effect impose an income tax upon the interest received on the farmers' first mortgages and would, therefore, be contrary to the manifest general purpose of Sec. 26 of the Federal Farm Loan Act which "expressly disavows any purpose to tax interest upon" the farmers' first mortgages and disavows any intention "to subject" such farmers' first mortgages "to burdens which could not be imposed upon those of a State" or municipality.

CONCLUSION.

In conclusion, plaintiff submits that the indebtedness of a Joint Stock Land Bank on its Joint Stock Land Bank Bonds, the proceeds of which are used to make loans to farmers on the security of qualified first mortgages (each loan being made in consideration of the making and delivery by the respective farmer of his mortgage note secured by his farm mortgage), as contemplated and defined in the Federal Farm Loan Act, does not fall within the interest deduction exception clause of Sec. 234 (a) (2) of the Revenue Act of 1921 as "indebtedness incurred or continued to purchase or carry obligations or securities the interest upon which is wholly exempt from taxation under this title" and that, therefore, the interest on such bonds is deductible by said Joint Stock Land Bank under Sec. 234 (a) (2) of the Income Tax Law of 1921.

Plaintiff submits that its interpretation is cumulatively confirmed by the following considerations:

(1) the general deductibility of interest on indebtedness (*supra*, p. 14) and the purpose of Congress in adopting the interest deduction exception clause (*supra*, p. 14);

(2) the actual language of the exception clause in the light of (a) the Congressional purpose in adopting the clause (*supra*, p. 14), (b) the type of indebtedness under consideration (*supra*, p. 16), and (c) its relation to the language of the interest exemption section (*supra*, p. 24),—all in view of the situation "as it was pressed upon the attention of the legislative body" (*supra*, p. 26) and the interpretations heretofore adopted by the Bureau of Internal Revenue in respect thereof.

(3) the purpose of Congress in creating the Federal Farm Loan System and its relation to the spirit and intended scope of the interest deduction exception clause (*supra* p. 28);

(4) the purpose of such Joint Stock Land Bank borrowings (*supra* p. 35) and the use of the proceeds thereof (*supra*, p. 38), as confirmed in the Federal Farm Loan Act, and their bearing on the question whether a Joint Stock Land Bank in borrowing to loan to a farmer on his mortgage note secured by his farm mortgage (incidentally acquired in the transaction) borrows "to purchase or carry" anything whatsoever;

(5) the meaning of the phrase "to purchase or carry", as used in the interest deduction exception clause, in view of (a) the transaction aimed at in the interest deduction exception clause (*supra* p. 19), (b) the ordinary meaning of the words, and (c) the meaning attributed to them by Congress in the contemporaneous language of the Federal Farm Loan Act (*supra* p. 21);

(6) the scope in the interest deduction exception clause of "obligations or securities the interest upon which is wholly exempt from taxation under this title" in the light of Congressional intent as evidenced in the purpose of the interest deduction exception clause and in its relation to the exemption section and the language thereof (*supra* p. 23);

(7) the scope of the exemption section phrase "securities issued under the provisions of the Federal Farm Loan Act" (as to whether it includes farmers' first mortgages) in the light of contemporaneous language of Congress (*supra* p. 53), the legislative history of the phrase "securities issued under the provisions of the Federal Farm Loan Act" (*supra* p. 55), the non-exemption in fact of interest on farmers' first mortgages under the Income Tax Law of 1921 (*supra* p. 58), the rulings of the Internal Revenue Bureau (*supra* p. 61) and the significance of the word "issued" in view of the uniform use of the word "issue" in the Federal Farm Loan Act as definitive of farm loan bonds (as distinguished from the uniform use of the words "qualified", "taken", etc. as definitive of farmers' first mortgages) (*supra* p. 62);

(8) the defendant's alternative interpretation (that the farmers' first mortgages, because of the

exemption contained in Sec. 26 of the Federal Farm Loan Act, are "obligations or securities the interest upon which is wholly exempt from taxation under this title") in the light of interrelation of the phraseology in the exception clause and the exemption section of the Income Tax Law (*supra* p. 72), the consequence of treating the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" as independent unrelated words without descriptive force as a unit (*supra* p. 74) and the necessary violence to the language of "exempt from taxation under this title" in view of the history of the phrase as disclosed in the Income Tax Laws (*supra* p. 76) and the significance of the precise language used as distinguished from the suggested equivalent "tax imposed by" (*supra* p. 77); and

(9) the rules of interpretation of statutes levying taxes as laid down by this Court (*supra* p. 79).

Reverting to the statement of questions involved (*supra* pp. 7-8), plaintiff submits that the above considerations clearly bespeak a negative answer not only to the preliminary inquiry (whether such indebtedness of a Joint Stock Land Bank is within the *spirit and intended scope* of the exception clause) but also to each of the three questions set forth in respect of the literal interpretation of the exception clause,—incidentally, a negative answer to the first of these questions determining the issue at the threshold.

Plaintiff further submits that its interpretation of the interest deduction exception clause gives full and direct effect both to the language of the exception clause and the purpose of Congress in adopting it and, moreover, is consistent with and harmonizes every intent of Congress evidenced or manifested in the Federal Farm Loan Act and in the Income Tax Laws, to wit, in the interest deduction exception clause, the interest exemption sec-

tion, the consolidated return provisions and the provisions in respect of tax-exempt corporations.

Plaintiff further submits that its interpretation is plain and direct,—notwithstanding the fact that the presentation and disclosing thereof has required much verbiage in view of the numerous statutes, propositions and related matters involved, including the discussion of the opinion of the Court of Claims.

Plaintiff further submits that the interpretations urged by the defendant are not plain and direct and that they are not reconcilable with the Congressional purpose, the Congressional language (and intent in respect thereof) and interpretations of the interest deduction exception clause heretofore adopted, and accepted by the Internal Revenue Bureau.

The constitutional considerations and the consequences thereof, based on the case of *Nauts* v. *Slayton*, plaintiff submits to the Court, collaterally and without extended argument, solely in the thought that they may be given such effect as the Court may deem necessary or pertinent herein,—in the light of its ultimate decision in the case of *Nauts* v. *Sldyton*.

Respectfully submitted,

HAROLD V. AMBERG,
Attorney for Plaintiff.

III.

APPENDIX.

For ready reference the pertinent parts of the "exemption" and "deduction" sections of the Income Tax Laws of 1913, 1916, 1917, 1918 and 1921 are reprinted in this appendix. Italics are ours.

ACT OF 1913.

Being Section II of the Act of October 3, 1913, entitled "An act to reduce tariff duties and to provide revenue for the Government and for other purposes".

B. That, *subject only to such exemptions and deductions as are hereinafter allowed,* * * * Interest exemption.

That in computing *net income* under this section there shall be excluded

the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions:

* * * * *

G. (a) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire *net income* arising or accruing from all sources during the preceding calendar year to every corporation, joint stock company or association * * * Deductions.

(b) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association * * *

(*first*) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a Ordinary business expense.

condition to the continued use or possession of property;

(*second*) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any;

* * * * * *

(*third*) *the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year:*

Provided, That in case of indebtedness wholly secured by collateral the subject of sale in the ordinary business of such corporation, joint stock company, or association, the total interest secured and paid by such company, corporation, or association within the year on any such indebtedness may be deducted as a part of its expense of doing business:

* * * * * *

(*fourth*) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country:

* * * * * *

(c) The tax herein imposed shall be computed upon its entire *net income* * * *.

ACT OF 1916.

Being Title I of the Act of September 8, 1916, cited as the "Revenue Act of 1916". (39 Stat. L. 756-77, C. 463.)

Part I.—On Individuals.

Income Defined.

SEC. 2. (a) (1) That *subject only to such exemptions and deductions as are hereinafter allowed* * * * Interest exemption.

SEC. 4. *The following income shall be exempt from the provisions of this title:*

* * * * * *

(4) interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal farm loan Act of July seventeenth, nineteen hundred and sixteen:

* * * * * *

Part II.—On Corporations.

Deductions.

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such *net income* shall be ascertained by deducting from the gross amount of its income received within the year from all sources— Deductions.

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity; Ordinary business expense.

Second. (1) All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including

Second. (2) a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade: * * *

Third. The amount of interest paid within the year on its indebtedness to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding:

Provided, further, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral: * * *

Fourth. Taxes paid within the year * * *.

ACT OF 1917.

Being Title I of the Revenue Act of 1916 as amended by Title XII of the Act of October 3, 1917, cited as the "Revenue Act of 1917". (40 Stat. L. 300-38, C. 63.)

Part I.—On Individuals.

Income Defined.

Interest exemption.

SEC. 1200. (1) That subdivision (a) of section two of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:

"(a) That, *subject only to such exemptions and deductions as are hereinafter allowed,* * * *"

SEC. 1200. (2) Section four of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:

"SEC. 4. The following income shall be exempt from the provisions of this title:

* * * * * *

(4) *interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States (but in the case of obligations of the United States issued after September first, nineteen hundred and seventeen, only if and to the extent provided in the Act authorizing the issue thereof) or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen:*"

Part II.—On Corporations.

Deductions.

Deductions.

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

Ordinary business expense.

First. All the ordinary and necessary expenses paid within the year in the maintenance and oper-

ation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity:

Second. (1) All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including * * *

Second. (2) a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

SEC. 1207. (1) (1) That paragraphs third and fourth of subdivision (a) of section twelve of such act of September eighth, nineteen hundred and sixteen, are hereby amended to read as follows:

SEC. 12. (a) "*Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding:*

* * * * *

Provided further, that in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company, or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral: * * *

SEC. 12. (a) "*Fourth.* Taxes paid within the year

* * *."

ACT OF 1918.

Being Title II of the Act of February 24, 1919, cited as the "Revenue Act of 1918". (40 Stat. L. 1057-96, C. 18.)

Part II.

Gross Income Defined.

Interest exemption.

SEC. 213. For the purposes of this title (except as otherwise provided in Section 233) the term "gross income" * * * (b) Does not include the following items, which shall be exempt from taxation under this title: (4) *Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916; *or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation:* * * * *In the case of obligations of the United States issued after September* 1, 1917, *and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under this title and under Title III.*

Part III. On Corporations.

Deductions.

Deductions.

SEC. 234 (a) That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:

dinary business expense.

SEC. 234 (a) (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

terest.

SEC. 234 (a) (2) *All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917) the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a foreign corporation, the proportion of such interest which the amount of its gross income from sources within the United States bears to the amount of its gross income from all sources within and without the United States:*

xes.

SEC. 234 (a) (3) Taxes paid or accrued within the taxable year * * *

sses.

SEC. 234 (a) (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

d debts.

SEC. 234 (a) (5) Debts ascertained to be worthless and charged off within the taxable year:

ACT OF 1921.

Being Title II of the Act of November 23, 1921, cited as the "Revenue Act of 1921". (42 Stat. L. 227, C. 136).

Part II.

Gross Income Defined.

Interest exemption.

SEC. 213 That for the purposes of this title (except as otherwise provided in section 233) the term "gross income", (b) Does not include the following items, which shall be exempt from taxation under this title: (4) *Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war profits and excess profits taxes.*

Part III. On Corporations.

Deductions Allowed Corporations.

Deductions.

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:

Ordinary business expense.

SEC. 234. (a) (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

Interest.

SEC. 234. (a) (2) *All interest paid or accrued within the taxable year on its indebtedness except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.*

Taxes.

SEC. 234. (a) (3) Taxes paid or accrued within the taxable year except * * *

Losses.

SEC. 234. (a) (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise * * *

Bad debts.

SEC. 234. (a) (5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); * * *

CHARTER
OF
JOINT STOCK LAND BANK
No. 33.

TREASURY DEPARTMENT
OFFICE OF THE FEDERAL FARM LOAN BOARD

WASHINGTON, D. C., February 24, 1922.

WHEREAS, by satisfactory evidence presented to the Federal Farm Loan Board, it has been made to appear that the First-Trust Joint Stock Land Bank of Chicago, of the City of Chicago, County of Cook, and State of Illinois, has complied with all the provisions of "The Federal Farm Loan act", required to be complied with before such bank shall be granted a charter;

NOW, THEREFORE, the Federal Farm Loan Board does hereby grant a charter to the First-Trust Joint Stock Land Bank of Chicago, of the City of Chicago, County of Cook, and State of Illinois, and said bank is hereby granted authority and power to loan money, issue its bonds, and to do all other things provided for, and in accordance with the provisions of the Act of Congress approved July 17, 1916, known as "The Federal Farm Loan Act", and to do all other things implied or incident thereto within the State of Illinois and the contiguous State of Iowa.

IN WITNESS WHEREOF, the Federal Farm Loan Board has caused this charter to be signed by its executive officer, the Farm Loan Commissioner, attested by its Secretary, and has caused its seal to be hereunto affixed this Twenty-fourth day of February, 1922.

FEDERAL FARM LOAN BOARD
By CHAS. E. LOBDELL
Farm Loan Commissioner.

Attest:
C. R. HEFLIN
(SEAL) *Assistant Secretary.*